Supreme Court, U.S.
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No. 04-

IN THE

Supreme Court of the United States

HANS W. FLAGG AND EILEEN S. FLAGG, on behalf of themselves and all others similarly situated,

Petitioners,

v.

YONKERS SAVINGS AND LOAN ASSOCIATION, FA, also known as Yonkers Financial,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the preemption by the Office of Thrift Supervision ("OTS") of state statutes requiring the payment of interest on balances in mortgage escrow accounts maintained for mortgage loans originated or serviced by federal savings and loan associations ("FS&L's") is inconsistent with Congress' intent as expressed under § 2616 of the Real Estate Settlement Procedures Act ("RESPA," 12 U.S.C. § 2601, *et seq.*), and as further interpreted by the Secretary of Housing and Urban Development (the "Secretary"), the agency official designated in 12 U.S.C. § 2616 to make preemption determinations with respect to mortgage escrow accounts for all federally-related mortgage loans?

2. Whether the OTS preemption regulations that "freed [Respondent and other FS&L's] from any legal duty to pay interest on mortgage escrow accounts" arising under state law constitutes a state action "nexus" sufficient to support a claim against Respondent under the Takings Clause of the Fifth Amendment to the United States Constitution?

TABLE OF CONTENTS

Page

Questions Presented i

Table of Contents ii

Table of Cited Authorities iv

Table of Appendices xi

Opinions Below 1

Statement of Jurisdiction 1

Constitutional, Statutory And Regulatory Provisions Involved 1

Statement of the Case 2

I. Factual Background 2

II. Statutory And Regulatory Background, Including Relevant Statutory And Regulatory History 3

A. The New York State Escrow Interest Statutes 3

B. RESPA, Its Savings Provision, And The Secretary's Regulations 5

C. HOLA And The OTS Escrow Interest Preemption Regulations 9

Contents

	Page
Reasons for Granting the Petition	13
I. Review Is Warranted Because The Second Circuit Opinion Substantially Departs From Or Fails To Consider This Court's Controlling And Other Pertinent Decisions	15
II. Review Is Warranted Because The Second Circuit Opinion Ignores And Misapplies This Court's Taking Decisions	24
III. Review Is Warranted Because The Important Federal And Constitutional Issues In This Case Have A Direct Effect On A Substantial Segment Of The U.S. Populace Who Have Been, And Will Be, Injured By The Challenged Escrow Interest Preemption	29
Conclusion	30

TABLE OF CITED AUTHORITIES

Page

CASES:

Adams v. City of Battle Creek,
250 F.3d 980 (6th Cir. 2001) 28

Am. Mfrs. Mut. Ins. Co. v. Sullivan,
526 U.S. 40 (1999) 27

Ames v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.,
567 F.2d 1174 (2d Cir. 1977) 28

Ashwander v. Tenn. Valley Auth.,
297 U.S. 288 (1936) 28

Atherton v. FDIC,
519 U.S. 213 (1997) 24

Bank of Am. v. City and County of San Francisco,
309 F.3d 551 (9th Cir. 2002) 19, 22

Blue Cross & Blue Shield of New Jersey, Inc. v. Phillip Morris, Inc.,
178 F. Supp. 2d 198 (E.D.N.Y. 2001),
aff'd in relevant part, 344 F.3d 211
(2d Cir. 2003) 18

Blum v. Yaretsky,
457 U.S. 991 (1982) 27

Brown v. Legal Found. of Wash.,
538 U.S. 216 (2003) 14

Cited Authorities

Page

Chevron U.S.A., Inc.
v. Natural Res. Def. Council, Inc.,
467 U.S. 837 (1984) 21, 22

Cliff v. Payco Gen. Am. Credits, Inc.,
363 F.3d 1113 (11th Cir. 2004) 18

Cmty. Bank & Trust v. United States,
54 Fed. Cl. 352 (Ct. Cl. 2002) 24

Cranley v. Nat'l Life Ins. Co.,
318 F.3d 105 (2d Cir. 2003) 25

FDA v. Brown & Williamson Tobacco Corp.,
529 U.S. 120 (2000) 21

FNMA v. Lefkowitz,
390 F. Supp. 1364 (S.D.N.Y. 1975) 4

Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta,
458 U.S. 141 (1982) ..... *passim*

First Fed. Sav. & Loan Ass'n of Boston
v. Greenwald,
591 F.2d 417 (1st Cir. 1979) 10, 20

First Fed. Sav. & Loan Ass'n of Jackson County
v. First Fed. Sav. & Loan Ass'n of Huntsville,
446 F. Supp. 210 (E.D. Ala. 1978) 26-27

Flagg v. Yonkers Sav. & Loan Ass'n, FA,
307 F. Supp. 2d 565 (S.D.N.Y. 2004)
aff'd, 396 F.3d 178 (2d Cir. 2005) ..... *passim*

Cited Authorities

Page

Geier v. Am. Honda Motor Co.,
529 U.S. 861 (2000) 23

Glosemeyer v. United States,
45 Fed. Cl. 771 (Ct. Cl. 2000) 25

Hines v. Davidowitz,
312 U.S. 52 (1941) 17

Jamaica Sav. Bank v. Lefkowitz,
390 F. Supp. 1357 (E.D.N.Y.),
aff'd, 423 U.S. 802 (1975) 4

Lorillard Tobacco Co. v. Reilly,
533 U.S. 525 (2001) 18

Lugar v. Edmondson Oil Co.,
457 U.S. 922 (1982) 27

Ma v. Ashcroft,
257 F.3d 1095 (9th Cir. 2001) 28

Marquette Nat'l Bank of Minneapolis
v. First of Omaha Serv. Corp.,
439 U.S. 299 (1978) 27

Martin v. Occupational Review Comm'n,
499 U.S. 144 (1991) 21

McIntyre v. Bayer,
339 F.3d 1097 (9th Cir. 2003) 24

Cited Authorities

Page

Medtronic, Inc. v. Lohr,
518 U.S. 470 (1996) 15, 18

In re New Times Sec. Servs., Inc.,
371 F.3d 68 (2d Cir. 2004) 21-22

Palsgraf v. Long Island R.R.,
248 N.Y. 339, 162 N.E. 99 (1928) 17

Phillips v. Washington Legal Found.,
524 U.S. 156 (1998) 14, 24

Retail Clerks v. Schermerhorn,
375 U.S. 96 (1963) 16

Rice v. Santa Fe Elevator Corp.,
331 U.S. 218 (1947) 17

Ruckelshaus v. Monsanto Co.,
467 U.S. 986 (1984) 25

San Francisco Arts & Athletics, Inc. v. United States Olympic Comm.,
483 U.S. 522 (1987) 27

Spinelli v. Gaughan,
12 F.3d 853 (9th Cir. 1993) 25

Swisher v. United States,
176 F. Supp. 2d 1100 (D. Kan. 2001) 25

United States v. Estate of Romani,
523 U.S. 517 (1998) 21

Cited Authorities

Page

United States v. Fausto,
484 U.S. 439 (1988) 21

United States v. Kimbell Foods, Inc.,
440 U.S. 715 (1979) 24

Webb's Fabulous Pharmacies, Inc. v. Beckwith,
449 U.S. 155 (1980) 24

STATUTES, REGULATIONS AND RELATED MATERIALS:

FEDERAL:

United States Constitution, Fifth Amendment .....
..... 2, 9, 10, 14, 20

12 U.S.C. § 1463(a) 5, 9

12 U.S.C. § 1464(a) 9, 10

12 U.S.C. § 2601(b)(3) 5

12 U.S.C. § 2602(1) 5

12 U.S.C. § 2605(g) 5

12 U.S.C. § 2606 19

12 U.S.C. § 2609(a)(2) 5

12 U.S.C. § 2609(b) 5, 15, 28

Cited Authorities

	Page
12 U.S.C. § 2609(c)(2)	5, 15, 28
12 U.S.C. § 2609(d)	5
12 U.S.C. § 2616	*passim*
28 U.S.C. § 1254(1)	1
28 U.S.C. § 1331	3
28 U.S.C. § 1367	3
12 C.F.R. § 34.4(a)(6)	30
12 C.F.R. § 545.2	2, 13, 22
12 C.F.R. § 545.6-11(c)	11
12 C.F.R. § 560.2	2, 11, 23
24 C.F.R. § 3500	6
24 C.F.R. § 3500.13	6
24 C.F.R. § 3500.17	6
48 Fed. Reg. 23032 (May 23, 1983)	11
59 Fed. Reg. 53890 (Oct. 26, 1994)	6
68 Fed. Reg. 46119 (Aug. 5, 2003)	29
69 Fed. Reg. 1904 (Jan. 13, 2004)	30

Cited Authorities

Page

Public Law 101-625, 104 Stat. 4411 (Nov. 28, 1990) 5

H.R. Conf. Rep. No. 93-1526 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6569 9

H.R. Rep. No. 94-667 (1975), *reprinted in* 1975 U.S.C.C.A.N. 2448 ..... 8, 29

STATE:

New York Banking Law § 6-k(2)(b) 3

New York Banking Law § 14(5) 3

New York General Obligations Law § 5-601 3

New York Real Property Tax Law § 953(2) 3

TABLE OF APPENDICES

Page

Appendix A — Opinion Of The United States Court Of Appeals For The Second Circuit Decided January 21, 2005 ..... 1a

Appendix B — Opinion And Order Of The United States District Court For The Southern District Of New York Dated March 8, 2004 ..... 16a

Appendix C — Order Of The United States Court Of Appeals For The Second Circuit Denying Petition For Rehearing Filed February 15, 2005 ..... 59a

Appendix D — Principal Statutes And Regulations Involved 61a

OPINIONS BELOW

The Opinion of the United States District Court for the Southern District of New York dismissing Petitioners' claims is reported at *Flagg v. Yonkers Sav. & Loan Ass'n, FA*, 307 F. Supp. 2d 565 (S.D.N.Y. 2004) (App. B, *infra*, 16a). The Opinion of the United States Court of Appeals for the Second Circuit affirming the dismissal by the district court is reported at 396 F.3d 178 (2d Cir. 2005) (App. A, *infra*, 1a). The Order of the Second Circuit denying Petitioners' petition for rehearing is unreported (App. C, *infra*, 59a).

STATEMENT OF JURISDICTION

The Second Circuit's Opinion was entered on January 21, 2005. The Second Circuit's Order denying Petitioners' timely petition for rehearing was entered on February 15, 2005. Petitioners invoke this Court's jurisdiction under 28 U.S.C. § 1254(1).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

The statutory basis for the mortgage escrow interest to which Petitioners claim entitlement is, *inter alia*, New York General Obligations Law ("GOL") Section 5-601, governing "Interest on deposits in escrow with mortgage investing institutions," and which generally requires the payment of 2% escrow interest on all escrow balances for New York residential mortgages (App. D, *infra*, 61a).

Congress' intent with respect to the preemption of state escrow laws is found in RESPA, and in particular the RESPA savings provision, 12 U.S.C. § 2616, "State laws unaffected; inconsistent Federal and State provisions" (App. D, *infra*, 61a-62a).

The principal statutory authority of the OTS to regulate FS&L's is found in the Home Owners' Loan Act of 1933 ("HOLA"), 12 U.S.C. § 1463(a) and § 1464(a) (App. D, *infra*, 62a-63a).

The OTS regulations preempting state escrow interest laws are 12 C.F.R. § 545.2 and 12 C.F.R. § 560.2 (App. D, *infra*, 63a-65a).

Petitioners' alternative taking claim is based on the Fifth Amendment to the United States Constitution, which provides that "private property [shall not] be taken for public use, without just compensation."

STATEMENT OF THE CASE

I. Factual Background

Petitioners Hans and Eileen Flagg entered into a mortgage agreement with Respondent FS&L Yonkers Savings and Loan Association, FA, on June 12, 1998 for their residence located in Westchester County, New York. At the time of closing, Petitioners had to deposit more than $4000 into an escrow account required to be maintained under the terms of the mortgage agreement for the payment of property taxes, insurance and other prescribed items. Monthly escrow account deposits required by Respondent ranged from $835-$1000, and the escrow account balance in some months exceeded $6000, during the life of the loan.

The standard form mortgage agreement included a term entitled "Lender's Obligations" regarding the payment of escrow interest, providing in relevant part:

> Lender will not be required to pay me any interest or earnings on the Funds [held in escrow] unless either (i) Lender and I agree in writing, at the time I sign this Security Instrument, that Lender will pay interest on the Funds; or (ii) the law requires Lender to pay interest on the Funds.

With respect to the governing law, the mortgage agreement stated: "This Security Instrument is governed by federal law and the law that applies in the place where the Property is located."

Respondent never paid Petitioners interest on their escrow account at any time before Respondent merged with the Atlantic Bank of New York ("Atlantic Bank") in May, 2002. After the

merger, Atlantic Bank, a New York State chartered banking institution, began to pay Petitioners interest on their escrow account under the same mortgage agreement. Petitioners estimate that the total escrow interest not paid by Respondent under New York law between 1998 and 2002 equals or exceeds $400.

Petitioners subsequently commenced a class action on behalf of themselves and other similarly situated borrowers who were not paid escrow interest by Respondent required under New York law. Petitioners' complaint, *inter alia*, sought a declaration that the New York statutes requiring the payment of escrow interest are preserved under RESPA, 12 U.S.C. § 2616, and also asserted a claim for breach of contract under the terms of the mortgage agreement. Alternatively, Petitioners asserted a taking claim under the Fifth Amendment to the U.S. Constitution, insofar as their entitlement to the prescribed escrow interest was determined to be preempted by the OTS and federal law. The jurisdiction of the district court was based on 28 U.S.C. § 1331, in that the complaint includes a claim asserted and arising under the Takings Clause of the Fifth Amendment, and under 28 U.S.C. § 1367 with respect to Petitioners' other claims involving substantial related federal questions.

II. Statutory And Regulatory Background, Including Relevant Statutory And Regulatory History

A. The New York State Escrow Interest Statutes

New York GOL § 5-601 obligates the payment of 2% interest on New York mortgage escrow accounts by all "mortgage investing institutions" (App. D, *infra*, 61a). "Mortgage investing institutions," in turn, are defined under New York Banking Law ("BL") § 14(5) to include "any bank, trust company, national bank, savings bank, savings and loan association [or] federal savings and loan association." New York Real Property Tax Law § 953(2) and BL § 6-k(2)(b) contain provisions comparable to GOL § 5-601 requiring the payment of interest by mortgage investing institutions in connection with escrow accounts established for the payment of real property

taxes and insurance premiums, respectively. There is no dispute that Respondent is a mortgage investing institution included within the ambit of the New York escrow interest statutes.

Some thirty years ago, the New York escrow interest statutes at issue in this case were upheld by a three judge panel in the face of challenges lodged by a state savings association and by the Federal National Mortgage Association ("FNMA"). *See Jamaica Sav. Bank v. Lefkowitz*, 390 F. Supp. 1357 (E.D.N.Y.), *aff'd*, 423 U.S. 802 (1975); *FNMA v. Lefkowitz*, 390 F. Supp. 1364 (S.D.N.Y. 1975). The three judge panel in *Jamaica Sav. Bank* specifically found that the statutes were enacted "for the benefit of a class [of homeowners] that needed protection," 390 F. Supp. at 1362-63, and described the New York legislature's purpose as follows:

> What occurred in this case was that the state legislature created a remedy to a problem it perceived – the inability of citizens seeking mortgages from mortgage lending institutions to bargain effectively for the use of funds put into the hands of the institutions to secure the mortgaged premises. . . . These mortgage agreements – almost all identical – were drafted by the [lender] and essentially were offered to potential mortgagors on a take it or leave it basis. 390 F. Supp. at 1362.

In rejecting the FNMA challenges to the statutes in *FNMA v. Lefkowitz*, 390 F. Supp. at 1369-70, the three judge panel also observed that the requirement to pay escrow interest "in no way" interfered with FNMA's functions or the ability of mortgagees (like Respondent) to protect their interest in property, because the purpose of requiring advance escrow deposits "is not to provide FNMA [or the lenders] with income."[1]

---

[1] In addition to New York, other states and federal territories with statutes requiring the payment of interest on mortgage escrow account (Cont'd)

B. RESPA, Its Savings Provision, And The Secretary's Regulations

RESPA was enacted in 1974, with the express purpose enumerated in 12 U.S.C. § 2601(b)(3) of "effect[ing] certain changes in the settlement process for residential real estate that will result . . . in a reduction in the amounts home buyers are required to place in escrow accounts established to insure the payment of real estate taxes and insurance[.]" The broad reach of RESPA is evidenced by its definition in 12 U.S.C. § 2602(1) of a covered "federally related mortgage loan," which extends to mortgage loans by virtually every federal and state bank, association and mortgage lender if, *inter alia*, the lender's deposits or accounts are federally insured or it is federally regulated.

As enacted in 1974, and as amended by Congress in 1990 under Public Law 101-625, 104 Stat. 4411 (Nov. 28, 1990), RESPA imposes escrow account restrictions and obligations on a lender beginning at closing and extending throughout the life of the escrow account.[2] Congress has designated the Secretary as the federal administrator with responsibility for issuing regulations and making other escrow account related determinations in furtherance of the purposes of RESPA.

(Cont'd)
balances include, *inter alia*, Connecticut and Vermont within the Second Circuit, Kentucky, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, Rhode Island, Wisconsin, Guam and the Virgin Islands.

[2] *See* 12 U.S.C. § 2605(g) (requiring loan servicer "to make payments from the escrow account . . . in a timely manner as such payments become due"); 12 U.S.C. § 2609(a)(2) (prescribing maximum amount lender may require borrower to place in escrow account); 12 U.S.C. § 2609(b) ("servicer shall notify the borrower not less than annually of any shortage of funds in the escrow account"); 12 U.S.C. § 2609(c)(2) (requiring annual escrow statements not less than once annually); 12 U.S.C. § 2609(d) (imposing penalties not exceeding $100,000 "for all such failures during any 12-month period").

See 12 U.S.C. § 2602(6); 12 U.S.C. § 2605(j)(3); 12 U.S.C. § 2609(c)(1)(C); 12 U.S.C. § 2616.

Congress' intent under RESPA with respect to federal preemption and the Secretary's preemption-authority is stated in 12 U.S.C. § 2616:

> This chapter does not annul, alter, or affect, or exempt any person subject to the provisions of this chapter from complying with, the laws of any State with respect to settlement practices, except to the extent that those laws are inconsistent with any provision of this chapter, and then only to the extent of the inconsistency. The Secretary is authorized to determine whether such inconsistencies exist. The Secretary may not determine that any State law is inconsistent with any provision of this chapter if the Secretary determines that such law gives greater protection to the consumer.

The Secretary's RESPA regulations are found at 24 C.F.R. § 3500. The regulation regarding escrow accounts is 24 C.F.R. § 3500.17. The escrow account regulation contains several instances where the Secretary specifically requires lenders and servicers to comply with state escrow laws that provide greater protection than § 3500.17. *See* 24 C.F.R. § 3500.17(c)(8) (Secretary's regulation applies unless state law provides for lower escrow account limit); 24 C.F.R. § 3500.17(d)(1)(i)(C) (escrow cushion is two months' payments or lesser amount specified by state law); 24 C.F.R. § 3500.17(d)(1)(ii) (lowest monthly balance is 1/6 total estimated disbursements or lesser amount specified by state law).

In 1994, the Secretary promulgated a number of amendments to the RESPA regulations. Included was a preemption regulation, 24 C.F.R. § 3500.13, "Relation to State laws," in furtherance of the RESPA savings provision, 12 U.S.C. § 2616. As the Secretary observed with respect to the preemption regulation, 59 Fed. Reg. 53890, 53900 (Oct. 26, 1994):

> *Regarding the possible preemption of State laws, the Department recognizes that many of the States have*

> *enacted laws relating to escrow accounts.* Section 18 of RESPA provides: "This Act does not annul, alter, or affect, or exempt any person subject to the provisions of (RESPA) from complying with, the laws of any State with respect to settlement practices, except to the extent that those laws are inconsistent with any provision of (RESPA), and then only to the extent of the inconsistency." 12 USC 2616. *Given this statutory language, and further statutory instruction that a state statute is not to be preempted if it gives greater protection to the consumer*, the Department believes it should make specific preemption decisions on a case-by-case basis. (emphasis added)

In the same Federal Register document, 59 Fed. Reg. at 53891, the Secretary also specifically discussed the obligation of the lender of a "federally related mortgage loan" to pay escrow interest if required under state laws:

> Interest on Escrow Accounts[.]
>
> Commenters asked whether the final rule would address interest on escrow accounts. Seven commenters suggested that the rule specifically exempt servicers that either pay interest on escrow accounts or service only one escrow item. These commenters believed that a required interest payment on escrow account balances would create a disincentive to servicers to over-escrow.
>
> After considering the comments, the Department determines that it will not create the requested exemptions. The Department does not interpret Section 10 of RESPA as providing the Department with legal authority to require payment of interest on escrow accounts. *Where interest is required, it is a matter of State law, with fourteen States requiring that some amount of interest be paid on escrow account funds.* (emphasis added)

RESPA's legislative history also demonstrates Congress' awareness of state statutes requiring the payment of escrow

interest when Congress considered and passed RESPA. First are the dissenting views of Rep. Leonor K. Sullivan in 1975 regarding RESPA's 1974 enactment, as found in H.R. Rep. No. 94-667 (1975), *reprinted in* 1975 U.S.C.C.A.N. 2448, 2461:

> In 1972, the Committee voted to include in the comprehensive Housing bill reported that year a provision calling upon the Federal Reserve Board to investigate the feasibility of requiring interest to be paid by mortgage lenders on the escrow accounts they require mortgagors to establish and maintain for the payment of taxes and casualty insurance. When the 1972 Housing bill died in the Rules Committee that year, I asked the General Accounting Office to make such a study, and it did so.
>
> The GAO reported that about $9 ½ billion was being placed over a year's time in such accounts on one to four family dwelling units, that an infinitessimal number of such accounts were interest bearing (except in the few states which require interest to be paid on such accounts) and that many lenders— particularly large institutions with many mortgages outstanding— derived substantial profits from the temporary investment of those funds.
>
> * * *
>
> Based on the GAO finding, *I proposed including in RESPA last year a provision which would not require interest to be paid on escrow accounts but instead would give individual home buyers the option of paying their own taxes and insurance rather than being required by the lender to maintain an interest-free escrow account for this purpose.* This proposal was rejected by the Committee last year and again on the bill now before us. . . . That is unfortunate, because many of our home-buying constituents with sizeable real estate tax bills each year would prefer to pay the taxes directly, meanwhile investing the money in

> interest-bearing accounts. Under most home mortgages, however, the home buyer does not have that option. . . . (emphasis added)

RESPA's 1974 legislative history also suggests that the House specifically considered the payment of escrow interest as related to the scope and purposes of RESPA:

> The House amendment contains a provision providing for the Federal Reserve Board to conduct a study by June 30, 1975, on the feasibility of lenders paying interest on escrow accounts and related questions. The Senate bill has no similar provision, and none is contained in the conference report. (emphasis added)

H.R. Conf. Rep. No. 93-1526 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6569, 6572. Importantly, the RESPA legislative history states the following regarding the preemption of state consumer protection laws *on the very same page* discussing "the feasibility of lenders paying interest on escrow accounts:"

> *The House amendment permits States to enforce consumer protection requirements in connection with residential real estate transactions in addition to requirements of this Act.* The Senate bill has no similar provision. The conference report contains the House provision with an amendment which would conform this provision to the recently enacted amendments to the Truth-in-Lending Act (Public Law 93-495) defining the relationship of that law to State laws [as enacted in 12 U.S.C. § 2616]. (emphasis added)

C. HOLA And The OTS Escrow Interest Preemption Regulations

Respondent and other FS&L's are chartered pursuant to HOLA, which was first enacted in 1933. The term "escrow account" does not appear even once in HOLA.

Congressional intent and authority for the Director of the Federal Home Loan Bank Board ("FHLBB") (now the OTS) to regulate FS&L's is found in 12 U.S.C. §§ 1463(a) and 1464 (a). Pursuant to 12 U.S.C. § 1463(a)(3) (App. D, *infra*, 62a),

Congress directed the OTS to "exercise all powers granted to the Director under this chapter so as to encourage savings associations to provide credit for housing safely and soundly." Pursuant to 12 U.S.C. § 1464(a) (App. D, *infra*, 63a), Congress directed the OTS to regulate the operations of federal savings associations "giving primary consideration of the best practices of thrift institutions in the United States . . . to encourage such institutions to provide credit for housing safely and soundly."

With the exception of 12 U.S.C. § 1463(g) regarding state usury laws, HOLA contains no provision specifically evidencing Congressional intent regarding the federal preemption of state laws. HOLA does, however, include a number of provisions specifically preserving and subjecting federal savings associations to state law, including: (i) 12 U.S.C. § 1464(b)(3) (borrowing from state housing finance agencies to same extent as state associations); (ii) 12 U.S.C. § 1464(h) (federal associations are subject to state and local taxes if not discriminatory); (iii) 12 U.S.C. § 1464(n)(1) (same "right to act as trustee . . . or in any other fiduciary capacity" as under state law); and (iv) 12 U.S.C. § 1464(n)(3) (oaths and affidavits under state law).

In the 1970's, FHLBB regulation 12 C.F.R. § 545.6-11(c) *required* the payment of interest on escrow funds by FS&L's if such payments were required of state lending institutions under state law where the FS&L's were located. *See First Fed. Sav. & Loan Ass'n of Boston v. Greenwald*, 591 F.2d 417, 420 n.3 (1st Cir. 1979).

In 1982, the Supreme Court issued its decision in *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982) ("*de la Cuesta*"). Specifically, the Court held that the FHLBB regulation permitting FS&L's to exercise the due-on-sale clause of a standard mortgage agreement – a clause the FHLBB considered critical to the business of banking by FS&L's – barred the application of a contrary state doctrine prohibiting

unreasonable restraints on alienation of property. 458 U.S. at 155, 168. In reaching its holding, the Supreme Court observed:

> The broad language of § [1464](a) expresses no limits on the Board's authority to regulate the lending practices of federal savings and loans. As one court put it, "[i]t would have been difficult for Congress to give the Bank Board a broader mandate." 458 U.S. at 161 (quoting *Glendale Federal Sav. & Loan Assn. v. Fox*, 459 F. Supp. 903, 910 (C.D. Cal.1978)).

Within one year after *de la Cuesta*, in 1983, the FHLBB eliminated all substantive regulations regarding escrow accounts, including 12 C.F.R. § 545.6-11(c), the substantive regulation requiring the payment of interest if so required under state law. As stated by the FHLBB at that time:

> In the final amendments the Board has decided to remove the substantive provisions pertaining to escrow accounts, allowing such matters to be governed by the loan contract and in their place require a more detailed disclosure about the accounts. Of course, associations will remain subject to the requirements of RESPA in addition to the Board's regulations and, if consistent with that statute, may require escrow accounts to the extent agreed to in the loan contact.
>
> * * *
>
> In light of this disclosure and the provisions of RESPA, the Board believes that the existing provisions on escrow accounts are no longer necessary and for that reason has deleted them.

48 Fed. Reg. 23032, 23039 (May 23, 1983).

In the place of specific substantive regulations, the FHLBB had, and the OTS now has, two regulations purporting generally to preempt all state laws affecting the operations of FS&L's, and directly at issue here. Most germane here is 12 C.F.R. § 560.2 (App. D, *infra*, 64a-65a), which governs federal

preemption in the lending and investment practices of FS&L's, and provides in relevant part:

> (a) Occupation of field. Pursuant to sections 4(a) and 5(a) of the HOLA, 12 U.S.C. 1463(a), 1464(a), OTS is authorized to promulgate regulations that preempt state laws affecting the operations of federal savings associations when deemed appropriate to facilitate the safe and sound operation of federal savings associations, to enable federal savings associations to conduct their operations in accordance with the best practices of thrift institutions in the United States, or to further other purposes of the HOLA. To enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices (by efficiently delivering low-cost credit to the public free from undue regulatory duplication and burden), *OTS hereby occupies the entire field of lending regulation for federal savings associations. OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation.* Accordingly, federal savings associations may extend credit as authorized under federal law, including this part, without regard to state laws purporting to regulate or otherwise affect their credit activities. . . . (emphasis added)
>
> (b) Illustrative examples. . . . [T]he types of state laws preempted by paragraph (a) of this section include, without limitation, state laws purporting to impose requirements regarding. . . .
>
> * * *
>
> (6) Escrow accounts, impound accounts, and similar accounts[.]

Additionally relevant is 12 C.F.R. § 545.2 (App. D, *infra*, 63a), the regulation governing the preemption of state laws in the general operations of FS&L's:

> The regulations in this part 545 are promulgated pursuant to the plenary and *exclusive authority of the Office to regulate all aspects of the operations of Federal savings associations*, as set forth in section 5(a) of the Act. This exercise of the Office's authority is preemptive of any state law purporting to address the subject of the operations of a Federal savings association. (emphasis added)

Since the promulgation of the preemption regulations in 1983, the FHLBB and OTS have issued a number of Opinion Letters reiterating their position that FS&L's are exempt from state escrow interest laws on federal preemption grounds. Respondent submitted a number of these letters to the district court in support of its motion to dismiss, and the district court credited the letters in its decision granting Respondent's motion (App. B, *infra*, 32a-34a).

In fact, Respondent also obtained and submitted an October 6, 2003 Opinion Letter from the OTS *in this litigation* to further establish that it was exempt from paying escrow interest under the OTS preemption regulations. The district court, however, declined to accord deference to the October 6, 2003 Opinion Letter, "because it does not address the impact of RESPA on [Petitioners'] contentions and thus fails to consider [Petitioners'] principal argument against the federal preemption of the New York statutes (App. B, *infra*, 32a-33a at n.12).

REASONS FOR GRANTING THE PETITION

The issue whether the preemption by the OTS of state escrow interest statutes is inconsistent with Congress' intent, as expressed under § 2616 of RESPA and as further interpreted by the Secretary, presents an important federal preemption issue. Its resolution by this Court affects hundreds of thousands of American citizens (or more) residing in the many states and territories that have seen fit to provide borrowers with the

additional protection of escrow interest preserved by Congress but improperly circumvented by the OTS. Aside from this Court's holdings establishing the primacy of Congressional intent and the presumption against preemption, the issue also implicates the Court's prior decisions regarding the appropriateness of the rules of specificity and recency as aids in resolving the interplay between different federal acts and statutes. Additionally, the issue implicates this Court's administrative law jurisprudence regarding the appropriate level of *Chevron* deference when the roles of two different federal agencies empowered under two different federal acts arguably intersect. It is fair to say that the Second Circuit either substantially departed from or simply failed to consider all of these controlling and other pertinent Supreme Court decisions.

The taking issue in this case is equally compelling. The issue is a natural extension of this Court's recent decisions in *Phillips v. Washington Legal Found.*, 524 U.S. 156 (1998), and *Brown v. Legal Found. of Wash.*, 538 U.S. 216 (2003), addressing the Fifth Amendment taking implications of the interest earned on funds deposited into IOLTA accounts. The Second Circuit's conclusion that the facts of this case lack the necessary state action to implicate the Takings Clause ignores the decisions of this and other courts, as well as the Opinions of the OTS, confirming that FS&L's are federal instrumentalities whose conduct can trigger constitutional protections. The Second Circuit similarly overlooked or misapplied the decisions of this Court that not just federal coercion, but "significant encouragement," can satisfy the nexus for state action sufficient to trigger Fifth Amendment protections. Simply stated, if the only reason a FS&L does not pay the escrow interest required by state law is because the OTS "frees" it from doing so (as the Second Circuit found here), then the failure to do so is (or should be, Petitioners contend) properly attributable to the federal government regardless of whether the FS&L is a federal instrumentality, or instead is merely the "private corporation" that the Second Circuit considered Respondent to be.

Unlike IOLTA interest, however, the escrow interest at issue here is readily calculable and payable to its owners. Escrow interest was and is paid by thousands of non-FS&L banking institutions nationally every year, and the proper amount can be derived from the escrow account information already required to be provided to all borrowers annually under 12 U.S.C. §§ 2609(b) and 2609(c)(2). It is fair to say that the borrowers affected by the OTS regulations could number in the hundreds of thousands or more, and the escrow interest taken could total in the hundreds of millions or more dollars – every year. This Court alone is in a position to definitively put an end to the improper FS&L escrow interest practices described herein, and to render a determination enabling affected borrowers to retain and recoup what is rightly theirs, while restoring the proper balance – prescribed by Congress and consistent with its intent – for the relationship between federal and state laws regarding escrow accounts, and the Constitutionally mandated respect for the property of mortgage borrowers.

I. Review Is Warranted Because The Second Circuit Opinion Substantially Departs From Or Fails To Consider This Court's Controlling And Other Pertinent Decisions

Petitioners argued to the Second Circuit, without success or even acknowledgment, that the appropriate framework for the preemption analysis in this case is the one set out by the Supreme Court, *inter alia*, in *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485-86 (1996):

> First, because the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action. In all pre-emption cases, and particularly in those in which Congress has "legislated . . . in a field which the States have traditionally occupied," *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S. Ct. 1146, 1152, 91 L. Ed. 1447 (1947), we "start with the assumption that the historic police powers of the States

were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." [*Id.*]

* * *

Second, our analysis of the scope of the statute's pre-emption is guided by our oft-repeated comment, initially made in *Retail Clerks v. Schermerhorn*, 375 U.S. 96, 103, 84 S. Ct. 219, 222, 11 L. Ed.2d 179 (1963), that "*[t]he purpose of Congress is the ultimate touchstone" in every pre-emption case. . . . As a result, any understanding of the scope of a pre-emption statute must rest primarily on "a fair understanding of congressional purpose.*" . . . Congress' intent, of course, primarily is discerned from the language of the pre-emption statute and the "statutory framework" surrounding it. . . . Also relevant, however, is the "structure and purpose of the statute as a whole," . . . as revealed not only in the text, but through the reviewing court's reasoned understanding of the way in which Congress intended the statute and its surrounding regulatory scheme to affect business, consumers, and the law. (emphasis added) (citations omitted)

The primacy of Congress' intent, as expressed in 12 U.S.C. § 2616, was turned on it head by the Second Circuit in the first two paragraphs of its legal analysis (App. A, *infra*, 5a-6a):

"Federal regulations have no less pre-emptive effect than federal statutes. Where Congress has directed an administrator to exercise his discretion, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily. When the administrator promulgates regulations intended to pre-empt state law, the court's inquiry is similarly limited." [quoting *de la Cuesta*, 458 U.S. at 153-54] . . .

> This evaluation is usually informed by a presumption in favor of the authority of state law in areas of activity traditionally allocated to the supervisory organs of the various states. *See Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S. Ct. 1146, 91 L. Ed. 1447 (1947). The presumption against federal preemption disappears, however, in fields of regulation that have been substantially occupied by federal authority for an extended period of time. . . . Regulation of federally chartered banks is one such area. [citations omitted]

It was no surprise where the Second Circuit's decision would lead, in light of its articulated analytic framework: (i) since banking is the field, the presumption against preemption is inapplicable; and (ii) a regulator's preemption regulations are just as valid as Congress' preemption statutes, and mandate deference (particularly in the field of banking). The title of the Second Circuit's preemption holding tells all – "Federal Law Preempts the Field of Mortgage Escrow Accounts Held by Federal Savings Associations" (App. A, *infra*, 3a).

To paraphrase then Chief Judge Cardozo in *Palsgraf v. Long Island R.R.*, 248 N.Y. 339, 341, 162 N.E. 99 (1928), "Proof of [banking] in the air, so to speak, will not do." As the Supreme Court explained in *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941):

> There is not – and from the very nature of the problem there cannot be – any rigid formula or rule which can be used. . . . Our primary function is to determine whether, *under the circumstances of this particular case*, [the state law] stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. (emphasis added)

Accord Rice v. Santa Fe Elevator Corp., 331 U.S. at 230 ("The question in each case is what the purpose of Congress was.").

Notwithstanding the broad language of *de la Cuesta* cited by the Second Circuit, this Court has never held that federal preemption regulations can *trump* the intent and purpose of Congress, or that Congress' purpose in any specific instance

can be arrived at based generally on the nature of the regulated field. To the contrary, although the Court's preemption decisions have evolved over the years, the unifying thread is Congress' intent and purpose, as gleaned from all of the appropriate sources enumerated, *inter alia*, in *Medtronic, supra*. The Second Circuit's preemption holding directly conflicts with Congress' intent, expressed in 12 U.S.C. § 2616, and the Secretary's interpretation in the Federal Register confirming the applicability of § 2616 to state escrow interest laws. *See* Statement of the Case II(B), *supra*.[3]

The Second Circuit also rejected Petitioners' challenge as to whether the OTS Director or the Secretary should be considered the proper federal administrator to issue preemption regulations regarding state escrow interest laws. Rather than address any potential conflict between these officials in this regard, the Second Circuit instead reconciled the ability of both administrators to make preemption determinations by the following analysis (App. A, *infra*, 10a-11a):

> First, RESPA and HOLA are not coextensive. RESPA applies to all mortgage loans that are "federally related." 12 U.S.C. § 2602. HOLA applies to federal

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[3] The Second Circuit's sweeping generalization about the reach of federal preemption in all issues banking also rejected *sub silencio* another of Petitioners' arguments – that this case involves the traditional state police powers regarding consumer protection, thus triggering, or at least implicating, the presumption against preemption. State consumer protection has been held to be such a "historic police power." *See Cliff v. Payco Gen. Am. Credits, Inc.*, 363 F.3d 1113, 1125 (11th Cir. 2004); *Blue Cross & Blue Shield of New Jersey, Inc. v. Phillip Morris, Inc.*, 178 F. Supp. 2d 198, 262 (E.D.N.Y. 2001), *aff'd in relevant part*, 344 F.3d 211 (2d Cir. 2003). *Cf. Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 541-42 (2001) (consumer advertising protection is historic state power entitled to presumption against preemption unless contrary intent of Congressional purpose). The Supreme Court, however, need not solely rely on presumptions here, in light of Congress' express statement in 12 U.S.C. § 2616 that state escrow laws providing "greater consumer protection" are not subject to preemption.

savings associations.12 U.S.C. § 1463. By design, then, RESPA regulates a narrow field of financial transactions engaged in by a broad group of financial institutions, *cf.* 12 U.S.C. § 2606 (describing exempted transactions), while HOLA regulates a specific breed of financial institutions in respect of all of their transactions and activities, *see, e.g., Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta,* 458 U.S. 141, 102 S. Ct. 3014, 73 L. Ed.2d 664 (1982) (due-on-sale clauses); *Bank of Am. v. City and County of San Francisco,* 309 F.3d 551 (9th Cir. 2002) (ATM charges).

Given that HOLA deals with institutions and RESPA deals with transactions, it simply does not make sense to read RESPA as superceding HOLA and preventing the OTS from asserting regulatory authority over the policies and practices of federal savings associations with respect to escrow accounts. The more sensible reading of these statutes is that federal savings associations, like all grantors of mortgage loans, must abide by RESPA as interpreted by the Secretary of Housing and Urban Development. The OTS cannot, therefore, promulgate rules and regulations that are contrary to RESPA. That this is so does not, however, exclude the OTS from preempting the field of rules governing federal savings associations and establishing nationwide regulations governing these institutions that are consistent with federal law, including RESPA.

Similarly, the Second Circuit's entire consideration of the import of 12 U.S.C. § 2616 was relegated to a single footnote (App. A, *infra*, 11a at n.2), stating:

> We have considered the Flaggs' argument that 12 U.S.C. § 2616 bars preemption. For those reasons stated that deal with the general relationship between RESPA and HOLA, we find this argument to be without merit.[4]

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[4] Though more detailed, the Second Circuit's analysis is analogous (Cont'd)

In so holding, the Second Circuit completely ignored the Secretary's published conclusions that a state "law[] regarding escrow accounts . . . is not to be preempted if it gives greater protection to the consumer"; "[w]here interest is required, it is a matter of State law, with fourteen States requiring that some amount of interest be paid on escrow account funds." 59 Fed. Reg. at 53891, 53900. Simply stated, the OTS here has done precisely what the Secretary has claimed it cannot do under RESPA – preempt state consumer escrow interest laws.

The Second Circuit's resort to logic and tautology is inconsistent with Congress' intent. Although it is true that FS&L's are "institutions" and mortgage loans are "transactions," the fact is that both HOLA and RESPA deal with the *"operations"* of banking institutions, with RESPA most specifically dealing with the narrow sliver of banking operations

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(Cont'd)

to the preemption analysis of the First Circuit in *First Fed. S&L Ass'n of Boston v. Greenwald*, 591 F.2d 417, 420 n.3 (1st Cir. 1979), the only other decision to specifically address the relationship of the RESPA saving clause to the authority of the FHLBB/OTS regarding escrow interest. The sum total of the *Greenwald* preemption analysis is as follows:

> The Commissioner reads s 2616 far too broadly. On its face s 2616 only states that "This chapter does not annul, alter, or affect, or exempt any person (from) the laws of any State with respect to settlement practices. . . ." (Emphasis added). Thus, s 2616 relates solely to the preemptive effect of 12 U.S.C. ch. 27, which consists only of RESPA. Section 2616's scope does not extend to 12 C.F.R. § 545.6-11(c), as it was promulgated by the Bank Board pursuant to the Home Owners' Loan Act, 12 U.S.C. § 1464(a), and not pursuant to RESPA.

The *Greenwald* preemption analysis is without citation to any Supreme Court decisions or any consideration of: (i) whether RESPA applies to FS&L's; and (ii) Congress' specific delegation to the Secretary of the authority to regulate escrow accounts and make preemption determinations. *Greenwald* is no more consistent with the preemption decisions of the Supreme Court than is the Second Circuit's Opinion in this case.

concerning the mortgage escrow account operations of all lenders and servicers of "federally related mortgage loans" throughout the life of the loan. With respect to this narrow, specific sliver, the Secretary is the federal official delegated by Congress to administer these operations, as supplemented by the Congressionally preserved power of the States to provide additional consumer protections.

The Supreme Court's decisions applying the rules of recency and specificity in connection with potential statutory conflicts were also brought to the Second Circuit's attention by Petitioners, but were ignored in light of the circuit court's reconciliation of HOLA and RESPA. As this Court stated in *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000): "[T]he meaning of one statute may be affected by other Acts, particularly where Congress has spoken subsequently and more specifically to the topic at hand." *See also United States v. Estate of Romani*, 523 U.S. 517, 530-531 (1998); *United States v. Fausto*, 484 U.S. 439, 453 (1988). In this case, there is no reference anywhere in HOLA to "escrow accounts," whereas escrow accounts are the *raison d'etre* for RESPA. Thus, Congress' earlier broad delegation to the OTS under HOLA should not be interpreted as overriding Congress' specific, subsequent intent regarding escrow accounts in RESPA.

Decisions of this Court dealing with potentially conflicting administrative delegations also confirm that the Second Circuit was required to defer here to the Secretary and the State's consumer protection powers preserved under RESPA. Judicial deference to an agency's regulatory interpretation under *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984), is appropriate *only* if that agency is the one to which Congress has delegated principal responsibility for the area regulated, with the greatest "expertise." *See, e.g., Martin v. Occupational Review Comm'n*, 499 U.S. 144, 152-53 (1991) (deference given only to agency in best position to interpret statute). *Cf. In re New Times Sec. Servs., Inc.*, 371 F.3d 68, 77-

80 (2d Cir. 2004) (declining *Chevron* deference to SIPC over SEC).[5]

Finally, although the Second Circuit was unable to "discern a critical difference between [*Bank of Am. v. City & County of San Francisco*, 309 F.3d 551 (9th Cir. 2002), and *de la Cuesta*] and the one at bar," (App. A, *infra*, 7a-8a), a close reading of those two opinions in light of this Court's other preemption decisions establishes that they do not support the Second Circuit's preemption holding.

In *Bank of Am.*, the Ninth Circuit considered both HOLA and the language and legislative history of the Electronic Funds Transfer Act ("EFTA") to hold that HOLA trumped the saving clause of the EFTA, and that the states were not allowed to regulate the ATM fees charged by FS&L's. First, 12 U.S.C. § 1464(b)(1)(F) of HOLA specifically addresses the right of FS&L's to "establish remote service units for the purpose of crediting [and debiting] savings or demand accounts." 309 F.3d at 559-60. Additionally, the EFTA language generally indicated that ATM fee limits were not intended within its ambit. *Id.* at 564. But most important, Congress' 1999 amendment to EFTA *specifically* allowed the charging of ATM fees – so long as notice and an opportunity to cancel the transaction were provided. *Id.* at 564-65. Thus, although ruling against applicability of the saving clause, the inconsistency between state laws and the most recent and specific expressions of Congressional intent was determinative.

de la Cuesta, 458 U.S. 141, deals with the broad powers that the FHLBB/OTS can properly exercise preemptively in the

[5] One of the two principal bases stated by the FHLBB/OTS for the preemption of state escrow interest laws – that the preemption regulations are promulgated "pursuant to the plenary and *exclusive authority* of the Office to regulate all aspects of the operations of Federal savings associations," *see* 12 C.F.R. § 545.2 (App. D, *infra*, 63a-64a) (emphasis added) – is legally erroneous. The OTS Director not only lacks "exclusive authority," but even "primary authority," to regulate the escrow accounts required to be maintained by FS&L's and all other "federally related mortgage" lenders.

face of state law generally. It does not address either RESPA or any conflict between HOLA and any other federal statute. Furthermore, in *de la Cuesta*, the FHLBB had determined that elimination of the due on sale clause "will have an adverse [e]ffect on the earning power and financial stability of Federal associations, will impair the ability of Federal associations to sell their loans in the secondary markets, will reduce the amount of home-financing funds available to potential home buyers, and generally will cause a rise in home loan interest rates." 458 U.S. at 168. In this case, in contrast, no adverse effect on the lending operations of FS&L's has ever been articulated, either by Respondent or the OTS.

The principal justification asserted by the OTS Director for its regulation preempting all state escrow account laws was "to give federal savings associations maximum flexibility to exercise their lending powers *in accordance with a uniform federal scheme of regulation.*" *See* 12 C.F.R. § 560.2(a) (App. D, *infra*, 64a) (emphasis added). That justification, however appropriate in connection with all of the other operations of FS&L's, cannot trump the interests of the various states, including New York, in implementing additional consumer protections in connection with escrow accounts that are greater than those prescribed under RESPA and the regulations promulgated thereunder. Here, 12 U.S.C. § 2616 establishes Congress' intent with respect to "federally related mortgage" escrow accounts – that the states' interest in consumer protection regarding mortgage escrow accounts *overrides* the federal interest in "maximum flexibility" or "uniformity pursuant to a federal scheme." *See Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 871 (2000) ("[T]he savings clause reflects a congressional determination that occasional nonuniformity is a small price to pay for a system in which juries not only create, but also enforce, safety standards, while simultaneously

providing necessary compensation to the victims. That policy by itself disfavors pre-emption[.]").[6]

In *de la Cuesta*, the Supreme Court observed, 458 U.S. at 167: "Although the Board's power to promulgate regulations exempting federal savings and loans from the requirements of state law may not be boundless, in this case we need not explore the outer limits of the Board's discretion." This is the case that resides at "the outer limits of the Board's discretion." But the location of its residence does not diminish its importance in the federal/state scheme.

II. Review Is Warranted Because The Second Circuit Opinion Ignores And Misapplies This Court's Taking Decisions

As this Court observed in *Phillips v. Washington Legal Found.*, 524 U.S. at 165:

> The rule that "interest follows principal" has been established under English common law since at least the mid-1700's. *Beckford v. Tobin*, 1 Ves. Sen. 308, 310, 27 Eng. Rep. 1049, 1051 (Ch. 1749) ("[I]nterest shall follow the principal, as the shadow the body"). Not surprisingly, this rule has become firmly embedded in the common law of the various States.

Other cases in addition to *Phillips* further confirm that the owner of funds held in escrow has a property right in the interest which is subject to the protections of the Takings Clause of the Fifth Amendment. *See Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980); *McIntyre v. Bayer*, 339 F.3d 1097, 1099-1100 (9th Cir. 2003) (prison inmates have cognizable Takings Clause property interest in interest on funds in inmate trust accounts); *Cmty. Bank & Trust v. United States*, 54 Fed. Cl. 352, 359 (Ct. Cl. 2002) (bank has cognizable Takings Clause

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[6] *Cf. Atherton v. FDIC*, 519 U.S. 213, 219-20 (1997) ("To invoke the concept of 'uniformity' . . . is not to prove its need."); *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 730 (1979) (rejecting "generalized pleas for uniformity as substitutes for concrete evidence that adopting state law would adversely affect administration of the federal programs").

property interest in income earned by Federal Reserve on funds held in reserve accounts).

Concomitantly, federal preemption of property rights without just compensation violates the Takings Clause. *See Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1012 (1984); *Spinelli v. Gaughan*, 12 F.3d 853, 858 n.5 (9th Cir. 1993); *Swisher v. United States*, 176 F. Supp. 2d 1100, 1102 (D. Kan. 2001); *Glosemeyer v. United States*, 45 Fed. Cl. 771, 776 (Ct. Cl. 2000).

Petitioners' federal taking claim was asserted on the basis of Respondent's affirmative representation that it was relying on OTS preemption and a federal preemption defense to avoid paying escrow interest, and that fact was affirmatively alleged in Petitioners' complaint and is uncontroverted. Respondent also sent a letter dated July 3, 2003 to the OTS requesting that the OTS issue an opinion letter *in this case* that the OTS regulations eliminate Respondent's obligation under New York law to pay escrow interest. The OTS obliged, by letter dated October 6, 2003, stating that defendant did not have to pay interest because the OTS said so under the OTS preemption regulations. The Second Circuit simply failed to address these facts in its Opinion.

To avoid the clear implication of these facts and the above-cited decisions, the Second Circuit substantially adopted the rationale of the district court (App. B, *infra*, 53a-57a) that the facts here do not implicate the Fifth Amendment because of a lack of "state action." According to the Second Circuit (App. A, *infra*, 14a-15a):

> *Though Yonkers is a "federal savings association," it is a private corporation*, not a state agency. "For the conduct of a private entity to be fairly attributable to the state, there must be such a close nexus between the State and the challenged action that seemingly private behavior may be fairly treated as that of the State itself." *Cranley v. Nat'l Life Ins. Co.*, 318 F.3d 105, 111 (2d Cir. 2003) (internal quotations omitted). A nexus of "state action" exists between a private entity and

> the state when "the state exercises coercive power, is entwined in the management or control of the private actor, or provides the private actor with significant encouragement, either overt or covert, or when the private actor operates as a willful participant in joint activity with the State or its agents, is controlled by an agency of the State, has been delegated a public function by the state, or is entwined with governmental policies." *Id.* at 112 (internal quotations and alterations omitted). By these well-established standards, no nexus existed between the OTS and Yonkers's decision not to pay interest on the Flaggs' escrow account.
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> *While federal law freed Yonkers, as a federal savings association, from any legal duty to pay interest on mortgage escrow accounts, there was no federal mandate prohibiting Yonkers from paying interest to the Flaggs or any other mortgagee-client. Neither did any state agent advise or command that Yonkers not pay interest on mortgage escrow accounts.* In fact, the OTS was neutral on the subject, leaving negotiation of interest payments on escrow accounts to the contracting parties. Neither the OTS nor any other state agency was party to the Flaggs' contract with Yonkers. There was no OTS-Yonkers joint enterprise; and no state function was delegated to Yonkers as a mortgagor. In short, Yonkers was a private entity participating in a regulated field of activity. Yonkers's actions were consistent with the law, to be sure, but obedience to the law alone does not create a sufficient nexus with the state to sustain a finding of "state action." (emphasis added)

The Second Circuit Opinion errs, first, because Respondent was not *merely* a "private corporation" for Fifth Amendment purposes. Rather, Respondent and all other FS&L's are federal instrumentalities. *See First Fed. Sav. & Loan Ass'n of Jackson County v. First Fed. Sav. & Loan Ass'n of Huntsville*, 446

F. Supp. 210, 212 (E.D. Ala. 1978) ("Federal associations are agencies and instrumentalities of the United States[.]"). *Cf. Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299, 308 (1978) ("Omaha Bank is a national bank; it is an 'instrumentalit[y] of the federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States.'") (citation omitted). As the OTS itself has recognized, "federal savings associations are *uniquely federalized financial institutions – even more so than national banks*." *See* OTS Opinion Letter dated December 24, 1996 regarding Preemption of State Laws Applicable to Credit Card Transactions (submitted by Respondent in support of motion to dismiss) (emphasis added). Federal instrumentalities are subject to constitutional limitations. *San Francisco Arts & Athletics, Inc. v. United States Olympic Comm.*, 483 U.S. 522, 549 (1987) (Brennan, J., dissenting).

Although recognizing it was the OTS regulations that "freed [Respondent] from any legal duty to pay interest on mortgage escrow accounts," the Second Circuit nevertheless held such circumstance insufficient for "state action," essentially because the OTS did not affirmatively prevent Respondent from paying escrow interest (App. A, *infra*, 15a). The Second Circuit's holding misconstrues or overlooks the decisions by this Court that substantial "encouragement" or "involvement" satisfies the "state action" nexus requirement. *See San Francisco Arts & Athletics, Inc.*, 483 U.S. at 546 (state action where government "has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the" government); *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 927 (1982) (state action where "there was overt, official involvement in the property deprivation"); *Blum v. Yaretsky*, 457 U.S. 991, 1003 (1982) (state action where defendant "sufficiently received the imprimatur of the State" or state is directly or indirectly "responsible for the specific conduct" of defendant). *Cf. Am. Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40, 52 (1999) (no state action when decision involves purely "private parties, and 'turns

on . . . judgments made by private parties' without 'standards . . . established by the State") (quoting *Blum*, 457 U.S. at 1008).

As this Court observed in *de la Cuesta*, 458 U.S. at 155:

> [Preemptive force] does not evaporate because the Board's regulation simply permits, but does not compel, federal savings and loans to include due-on-sale clauses in their contracts and to enforce those provisions when the security property is transferred.

The Court's observation is particularly apt here. It is Respondent's willful assertion of preemption under the OTS regulation that constitutes state action, regardless of whether that assertion is an "option" provided to it by the OTS, or a requirement. Either way, the state action nexus is satisfied. And the fact that the taken interest can be readily calculated from the same escrow account information already required to be provided to all borrowers annually under 12 U.S.C. §§ 2609(b) and 2609(c)(2) eliminates any uncertainty as to the taking's existence.

Petitioners finally observe that they encouraged the Second Circuit to obviate the need to consider the taking claim by following the well-established rule that "a regulation should be construed, whenever possible, so as to avoid constitutional issues." *Ames v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 567 F.2d 1174, 1181, n.7, 1182 (2d Cir. 1977). *See also, e.g., Ashwander v. Tenn. Valley Auth.*, 297 U.S. 288, 348 (1936); *Ma v. Ashcroft*, 257 F.3d 1095, 1106 (9th Cir. 2001); *Adams v. City of Battle Creek,* 250 F.3d 980, 986 (6th Cir. 2001). Petitioners' pleas fell on unreceptive ears. Petitioners hope their entreaty will prove more persuasive with this Court.

III. Review Is Warranted Because The Important Federal And Constitutional Issues In This Case Have A Direct Effect On A Substantial Segment Of The U.S. Populace Who Have Been, And Will Be, Injured By The Challenged Escrow Interest Preemption

As Rep. Leonor K. Sullivan stated in 1975, H.R. Rep. No. 94-667 (1975), *reprinted in* 1975 U.S.C.C.A.N. 2448, 2461: "The GAO reported that about $9 ½ billion was being placed over a year's time in such accounts on one to four family dwelling units[.]" Petitioners have no hard figures concerning the present amount, but with the geometric increase in housing prices and the costs of taxes and insurance since 1974, an estimate 10 times that amount, equaling $90.5 billion dollars annually, would not seem unreasonable. At a modest 2% per year, the interest on that principal could total almost $2 billion or more. And as Petitioners observed, *supra*, it is reasonable to estimate that the amount attributable solely to FS&L's in the states requiring the payment of interest could involve hundreds of thousands or more borrowers and hundreds of millions or more dollars of escrow interest – every year.

There is more. At the time this action first was commenced, to the best of Petitioners' knowledge, FS&L's were the only banking institutions who were not required to pay the interest on escrow balances prescribed under state law. National banks and national associations, by comparison, did pay escrow interest required by state law, the same as all other state banking institutions. But the uniqueness of the FS&L preemption exemption has now changed.

In August, 2003, the Office of the Comptroller of the Currency ("OCC") published substantial proposed revisions to its prior regulations in the Federal Register, 68 Fed. Reg. 46119 (Aug. 5, 2003). The proposed revisions, involving 12 C.F.R. Parts 7 and 34, included "provisions clarifying the applicability of state law to national banks."

In January, 2004, the OCC published the final regulations, which became effective on February 12, 2004. *See* 69 Fed. Reg. 1904 (Jan. 13, 2004). The new and revised regulations included revised 12 C.F.R. § 34.4(a)(6) – which now specifically provides that "[a] national bank may make real estate loans under 12 U.S.C. 371 and § 34.3, without regard to state law limitations concerning. . . . (6) Escrow accounts, impound accounts and similar accounts." 69 Fed. Reg. at 1917.

Thus, wholly aside from the legal importance of this case, which Petitioners believe is great, the economic importance of the case has been ratcheted up substantially since it was commenced, as a result of the new OCC preemption regulations mirroring those by the OTS. Regulator conduct this far-reaching is something, Petitioners respectfully contend, that this Court should address, particularly in light of the substantial federalism and Constitutional implications engendered.

CONCLUSION

For all of the foregoing reasons, Petitioners respectfully request that the Supreme Court grant review of this matter.

Respectfully submitted,

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APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DECIDED JANUARY 21, 2005

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

August Term, 2004

(Argued: November 18, 2004 Decided: January 21, 2005)

Docket No. 04-1948-CV

HANS W. FLAGG AND EILEEN S. FLAGG, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

—v.—

YONKERS SAVINGS AND LOAN ASSOCIATION, FA, also known as Yonkers Financial,

Defendant-Appellee.

Before:

OAKES, CALABRESI, and STRAUB, Circuit Judges.

Appeal from a judgment of the United States District Court for the Southern District of New York (William C. Conner, *Judge*) dismissing the complaint pursuant to Federal Rule of Civil Procedure 12(b)(6). Affirmed

Appendix A

STRAUB, Circuit Judge.

The small universe of facts germane to the present appeal is set forth in the decision of the District Court, reported at *Flagg v. Yonkers Sav. & Loan Ass'n,* 307 F.Supp.2d 565 (S.D.N.Y.2004). We recite them here only briefly.

Plaintiffs-Appellants Hans and Eileen Flagg (the "Flaggs") entered into a mortgage agreement with defendant-appellee Yonkers Savings and Loan Association ("Yonkers") on June 12, 1998. Pursuant to that agreement, and consistent with federal laws and guidelines that regulate Yonkers as a federal savings association, the Flaggs deposited funds into an escrow account from which property taxes, insurance, and other fees associated with the mortgaged property were to be paid. In relation to these escrow funds, the mortgage agreement provided that "Lender will not be required to pay me any interest or earnings on the Funds unless either (i) Lender and I agree in writing at the time I sign this Security Instrument, that Lender will pay interest on the Funds; or (ii) the law requires Lender to pay interest on the Funds." The principal issue on appeal is whether "the law" so required.

Until May 2002 Yonkers did not pay interest to the Flaggs on funds held in the escrow account. In May 2002 Yonkers merged with Atlantic Bank of New York ("Atlantic"), a wholly-owned subsidiary of the National Bank of Greece. After this merger Atlantic began to pay interest on the funds held in the Flaggs' mortgage escrow account. The Flaggs subsequently sued Yonkers based on New York statutes, New York common law, and the Fifth Amendment to the

United States Constitution, seeking declaratory judgment and compensation for past interest that they allege is owed to them under New York law for the pre-merger period. Yonkers moved for dismissal for failure to state a claim upon which relief could be granted. The Flaggs cross-moved for summary judgment. By its March 8, 2004, decision, the District Court granted Yonkers's motion and denied the Flaggs' motion as moot based on its determination that federal law and regulations had preempted the field of mortgage escrow accounts held by federal savings associations and its finding that federal law did not mandate payment of interest on such accounts. The Flaggs now appeal. We affirm.

DISCUSSION

The Flaggs raise three issues on appeal. First, they maintain that New York State law required that Yonkers pay them interest on their mortgage escrow account. Second, they contend that the contract governing their mortgage escrow account incorporated New York law, thereby obligating Yonkers to pay interest on the account under the contract. Third, the Flaggs assert that the District Court erred in dismissing their Fifth Amendment claim. We do not find merit in any of these arguments.

I. *Federal Law Preempts the Field of Mortgage Escrow Accounts Held by Federal Savings Associations.*

New York law requires "mortgage investing institutions" to pay interest on mortgage escrow accounts on a quarterly basis at a rate of "not less than two percentum per year based on the average of the sums so paid for the average length of

time on deposit or a rate prescribed by the banking board pursuant to section fourteen-b of the banking law and pursuant to the terms and conditions set forth in that section whichever is higher." N.Y. Gen. Oblig. Law § 5-601; *see also* N.Y. Banking L. § 14-b (describing the power of the New York Banking Board to prescribe minimum rates of interest to be paid on residential mortgage escrow accounts). Looking at Yonkers's failure to pay interest on their mortgage escrow account through the lens of these statutory provisions the Flaggs cannot be blamed for thinking that they were denied something due to them. No matter how intense their outrage, however, they cannot claim that they suffered any injustice because preemptive exercise of federal authority by the Office of Thrift Supervision freed Yonkers, as a federal savings association, from any obligation to pay interest on mortgage escrow accounts under New York law.

Pursuant to the authority granted to it by the Home Owners' Loan Act, 12 U.S.C. § 1461 *et seq.* ("HOLA"), the Office of Thrift Supervision ("OTS"), which operates under the aegis of the Department of Treasury to provide for, *inter alia,* the "examination, safe and sound operation, and regulation of savings associations," 12 U.S.C. § 1463(a)(1), has "authority [that] is preemptive of any state law purporting to address the subject of the operations of a Federal savings association." 12 C.F.R. § 545.2. Seized of this authority, the OTS has "occupie[d] the entire field of lending regulation for federal savings associations." 12 C.F.R. § 560.2(a). Among these are "laws purporting to impose requirements regarding . . . [e]scrow accounts." 12 C.F.R. § 560.2(b). In exercise of this asserted authority, the OTS has removed all legal obligations that federal savings associations may

have to pay interest on mortgage escrow accounts, "allowing such matters to be governed by the loan contract." 48 Fed.Reg. 23032.01, 23039 (May 23, 1983). Based on these statutory and regulatory sections, the District Court found that OTS regulations preempted state law in areas affecting federal savings and loan institutions. *Flagg,* 307 F.Supp.2d at 574-75.

On appeal the Flaggs do not contest the District Court's determination that the OTS has preempted state law with respect to the provision of interest on mortgage escrow accounts; rather, the Flaggs contend that this OTS action exceeds the authority granted to it by HOLA and is an arbitrary and unreasonable exercise of its regulatory power. We do not agree. Consistent with the District Court, we find that the exercise of authority here is neither arbitrary nor unreasonable and is within the broad grant of power to the OTS contained in HOLA.

"Federal regulations have no less pre-emptive effect than federal statutes. Where Congress has directed an administrator to exercise his discretion, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily. When the administrator promulgates regulations intended to pre-empt state law, the court's inquiry is similarly limited." *Fid. Fed. Sav. & Loan Ass'n. v. de la Cuesta,* 458 U.S. 141, 153-154 (1982) (internal citations omitted); *see also La. Pub. Serv. Comm'n. v. F.C.C.,* 476 U.S. 355, 374 (1986) ("[A] federal agency may pre-empt state law only when and if it is acting within the scope of its congressionally delegated

authority. . . . [T]he best way of determining whether Congress intended the regulations of an administrative agency to displace state law is to examine the nature and scope of the authority granted by Congress to the agency." (internal citations omitted)).

This evaluation is usually informed by a presumption in favor of the authority of state law in areas of activity traditionally allocated to the supervisory organs of the various states. *See Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). The presumption against federal preemption disappears, however, in fields of regulation that have been substantially occupied by federal authority for an extended period of time. *See United States v. Locke*, 529 U.S. 89, 108 (2000). Regulation of federally chartered banks is one such area. *See Barnett Bank, N.A. v. Nelson*, 517 U.S. 25, 32-33 (1996) (citing cases dating to 1877 that document the long history of federal regulations' preempting of state laws that purport to govern federally chartered banks); *Bank of Am. v. City and County of San Francisco*, 309 F.3d 551, 558 (9th Cir.2002) (tracing the history of federal preemption of state laws that purport to govern federally chartered banks to *McCulloch v. Maryland*, 17 U.S. 316 (1819)).

HOLA, in pertinent part, provides that "[t]he Director [of the OTS] *may issue such regulations as the Director determines to be appropriate* to carry out the responsibilities of the Director or the Office," 12 U.S.C. § 1463(a)(2) (emphasis added), and that "the Director is authorized, *under such regulations as the Director may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as Federal*

savings associations." *Id.* § 1464(a) (emphasis added). This is an extremely broad grant of power that provides ample authority for the Director's efforts to enforce consistent, nationwide regulations affecting lending practices, by preempting, *inter alia,* "state laws purporting to impose requirements regarding . . . [e]scrow accounts." 12 C.F.R. § 560.2(b).

While the propriety of this particular use of regulative power by the OTS appears to present a novel question in this Circuit, there is ample analogous precedent to demonstrate that this exercise of preemption is within reason and HOLA's grant of authority. In *de la Cuesta,* for example, the Supreme Court was asked to consider the OTS's authority to promulgate and enforce 12 C.F.R. § 545.8, which regulates the inclusion of "due-on-sale clauses" in mortgage agreements. In that regulatory provision, the Federal Home Loan Bank Board, the predecessor to the OTS, exhibits a clear intention to pre-empt state regulations dealing with due-on-sale clauses incorporated into mortgage agreements. 458 U.S. at 154, 158. Relying on the legislative history of HOLA and the language of the statute, the Supreme Court held that preemption of mortgage contracts was a reasonable exercise of the broad authority granted to the regulator by authority of HOLA. *Id.* at 159-67. Similarly, in *Bank of America v. City and County of San Francisco,* the Ninth Circuit Court of Appeals was asked to review the authority of the OTS to establish and enforce regulations affecting ATM charges. 309 F.3d at 558. Relying in part on 12 C.F.R. § 560.2, the court held that HOLA and OTS regulations have preempted the field of law affecting ATM transactions with federal savings associations and, therefore, have preempted conflicting local rules. *Id.* at 560-61.

We cannot discern a critical difference between these cases and the one at bar. HOLA gives a broad grant of authority to the OTS. We see no basis for concluding that the use of that authority here is outside the authority of the OTS.

We also find that the OTS's use of its authority in this case is not arbitrary. We recognize the potential interest that the OTS has in providing for consistency across the field of mortgage accounts offered by federal savings associations. *See* 12 C.F.R. § 560.2 (stating desire to "give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation" as a motive for exercise of OTS preemptive authority over, *inter alia*, "[e]scrow accounts"). The choice made here, to relieve institutions of any legal duty to pay interest on escrow funds while preserving the possibility that individual institutions and their clients may negotiate provision of some interest, provides a consistent nationwide playing field while giving individual institutions a level of flexibility. This achievement alone demonstrates that preemption in this field is sensible enough to dodge accusations of arbitrariness in the abstract.

More concretely, the Flaggs claim that the OTS regulation releasing federal savings associations from responsibility to pay interest on escrow funds is unreasonable and without authority because it is inconsistent with provisions of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2601 *et seq.* The purpose of RESPA is to address "certain abusive practices that have developed" in relation to the disclosure of information regarding the

"nature and costs of the [real estate] settlement process." 12 U.S.C. § 2601. RESPA generally requires that lenders disburse escrow funds in an appropriate and timely manner and that they provide regular reporting of such disbursements.[1] Authority to establish rules and regulations governing RESPA is assigned to the Secretary of Housing and Urban Development. *See* 12 U.S.C. §§ 2602(1)(B)(6), 2617.

Most germane to the present case is RESPA's interest in effecting a "reduction in the amounts home buyers are required to place in escrow accounts established to insure the payment of real estate taxes and insurance." 12 U.S.C. § 2601(b)(3). Specifically, 12 U.S.C. § 2609(a) limits the amount of money that a borrower can be required to deposit in an escrow account established for the purpose of paying taxes, fees and insurance. The Flaggs argue that this provision modifies or supercedes HOLA because the New York requirement that lenders pay interest on escrow funds reduces the overall amount of money that a borrower needs to contribute in order to pay taxes, fees, and insurance premiums. Given this, the Flaggs contend that rules governing provision of interest on escrow accounts must give way to the authority of both RESPA and the Department of Housing and Urban Development, though other aspects of

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1. That the OTS understands its obligations to issue regulations consistent with RESPA is evident by its disclosure rules, which specifically reference RESPA. *See* 48 Fed.Reg. 23032. That Yonkers attempted to abide by these legislative rules is evidenced in the mortgage agreement, which discusses legal limits on amounts that Yonkers may require the Flaggs to deposit in escrow and describes Yonkers's duties of reporting and disclosure.

federal savings associations' activities will remain under the authority of HOLA and the OTS. Given that New York law in this case provides added consumer benefits, the Flaggs conclude that the OTS would exceed its RESPA limited authority were it to preempt New York law in this circumstance. While creative, we do not find this argument persuasive for two principal reasons.

First, RESPA and HOLA are not coextensive. RESPA applies to all mortgage loans that are "federally related." 12 U.S.C. § 2602. HOLA applies to federal savings associations. 12 U.S.C. § 1463. By design, then, RESPA regulates a narrow field of financial transactions engaged in by a broad group of financial institutions, *cf.* 12 U.S.C. § 2606 (describing exempted transactions), while HOLA regulates a specific breed of financial institutions in respect of all of their transactions and activities, *see, e.g., Fid. Fed. Sav. & Loan Ass'n. v. de la Cuesta,* 458 U.S. 141 (1982) (due-on-sale clauses); *Bank of Am. v. City and County of San Francisco,* 309 F.3d 551 (9th Cir.2002) (ATM charges).

Given that HOLA deals with institutions and RESPA deals with transactions, it simply does not make sense to read RESPA as superceding HOLA and preventing the OTS from asserting regulatory authority over the policies and practices of federal savings associations with respect to escrow accounts. The more sensible reading of these statutes is that federal savings associations, like all grantors of mortgage loans, must abide by RESPA as interpreted by the Secretary of Housing and Urban Development. The OTS cannot, therefore, promulgate rules and regulations that are contrary to RESPA. That this is so does not, however, exclude

the OTS from preempting the field of rules governing federal savings associations and establishing nationwide regulations governing these institutions that are consistent with federal law, including RESPA.[2]

Second, the Flaggs' reliance on RESPA's statement of purpose found at 12 U.S.C. § 2601(b)(3) is misplaced. RESPA is meant to regulate the amount of money that a borrower is required to deposit in escrow by tying that amount to the costs the escrow fund is meant to secure. RESPA is not, however, designed to reduce the dollar costs of taxes, fees, and insurance premiums. RESPA can, and does, accomplish its task by setting rules on required escrow contributions. That this system may, in the end, be more expensive to borrowers than, say, keeping their money in interest-bearing accounts to pay their own bills, does not violate RESPA's stated goal of "reduc[ing] the amounts home buyers are required to place in escrow accounts." 12 U.S.C. § 2601(b)(3).

The Flaggs express some concerns that mortgage contracts are prepared by lending institutions and constitute contracts of adhesion. However, this particular contract specifically provides an opportunity for mortgagees of Yonkers to negotiate, by separate agreement, payment of interest on escrow accounts. It cannot, therefore, be a contract of adhesion. Moreover, the Flaggs do not appear to have attempted to negotiate interest terms on their escrow account.

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2. We have considered the Flaggs' argument that 12 U.S.C. § 2616 bars preemption. For those reasons stated that deal with the general relationship between RESPA and HOLA, we find this argument to be without merit.

Having failed to take advantage of the invitation extended in the contract, the Flaggs' argument that the contract, by virtue of disparities in power between the parties, was effectively a contract of adhesion fails to persuade. Their argument is only made less persuasive when one considers that Atlantic, which currently is host to the Flaggs' account, *does* pay interest on mortgage escrow accounts. This fact suggests that the mortgage-lender marketplace is inhabited by lenders who *do* pay interest on mortgage escrow accounts, providing both options and bargaining power to borrowers such as the Flaggs.

II. *The Mortgage Contract Does Not Incorporate State Law.*

The Flaggs contend that, even if Yonkers was not bound by New York law requiring payment of interest on mortgage escrow accounts, their contract with Yonkers incorporated New York law, therefore requiring that Yonkers pay interest to the Flaggs under the contract. In support of this argument, the Flaggs point to section fifteen of the contract, titled "Law that Governs this Security Instrument." That section reads, in its entirety:

> This Security Instrument is governed by federal law and the law that applies in the place where the Property is located. If any term of this Security Instrument or of the Note conflicts with the law, all other terms of this Security Instrument and of the Note will still remain in effect if they can be given effect without the conflicting term. This means that any terms of this Security Instrument and of the Note which conflict with the law can

> be separated from the remaining terms, and the remaining terms will still be enforced.

This section of the contract, is, by title and content, a choice of law provision. While contracts may incorporate particular laws as contract terms, the contract must do so with specificity. General choice of law provisions do not accomplish this task. *See Shaw Group, Inc. v. Triplefine Int'l Corp.*, 322 F.3d 115, 123 (2d Cir.2003) (without clear language of incorporation, a general choice of law provision was held not to have incorporated New York arbitration law into a contract).

The contract specifically states that Yonkers will not pay interest on the account unless required by law. Since, per HOLA and OTS regulations, Yonkers is not required by law to pay interest, the contract does not commit Yonkers to pay interest to the Flaggs on this mortgage escrow account.

III. *The Flaggs' Fifth Amendment Claim Fails.*

The Flaggs claim that Yonkers's failure to pay interest on amounts held in the mortgage escrow account constituted an uncompensated taking in violation of their Fifth Amendment rights. The District Court granted Yonkers's motion to dismiss this claim based primarily on its finding that there was no state action. *Flagg v. Yonkers Sav. & Loan Ass'n.*, 307 F.Supp.2d 565, 585 (S.D.N.Y.2004). We agree.

"Because the United States Constitution regulates only the Government, not private parties, a litigant claiming that his constitutional rights have been violated must first

establish that the challenged conduct constitutes 'state action.'" *United States v. Int'l. Bhd. of Teamsters,* 941 F.2d 1292, 1295 (2d Cir.1991). "[S]tate action requires *both* an alleged constitutional deprivation 'caused by the exercise of some right or privilege created by the State or by a rule of conduct imposed by the State or by a person for whom the State is responsible,' *and* that 'the party charged with the deprivation must be a person who may fairly be said to be a state actor.'" *Am. Mfrs. Mut. Ins. Co. v. Sullivan,* 526 U.S. 40, 50 (1999) (quoting *Lugar v. Edmondson Oil Co.,* 457 U.S. 922, 937 (1982)). While Yonkers's election not to pay interest to the Flaggs on their escrow account may qualify as an "exercise" of a "privilege created by the State," its action is not "fairly attributable to the State," *Sullivan,* 526 U.S. at 50, and, therefore, it was not a "state actor" for purposes of evaluating the legal merits of the Flaggs' takings claim.

Though Yonkers is a "federal savings association," it is a private corporation, not a state agency. "For the conduct of a private entity to be fairly attributable to the state, there must be such a close nexus between the State and the challenged action that seemingly private behavior may be fairly treated as that of the State itself." *Cranley v. Nat'l Life Ins. Co.,* 318 F.3d 105, 111 (2d Cir.2003) (internal quotations omitted). A nexus of "state action" exists between a private entity and the state when "the state exercises coercive power, is entwined in the management or control of the private actor, or provides the private actor with significant encouragement, either overt or covert, or when the private actor operates as a willful participant in joint activity with the State or its agents, is controlled by an agency of the State, has been delegated a public function by the state, or is entwined with governmental

policies." *Id.* at 112 (internal quotations and alterations omitted). By these well-established standards, no nexus existed between the OTS and Yonkers's decision not to pay interest on the Flaggs' escrow account.

While federal law freed Yonkers, as a federal savings association, from any legal duty to pay interest on mortgage escrow accounts, there was no federal mandate prohibiting Yonkers from paying interest to the Flaggs or any other mortgagee-client. Neither did any state agent advise or command that Yonkers not pay interest on mortgage escrow accounts. In fact, the OTS was neutral on the subject, leaving negotiation of interest payments on escrow accounts to the contracting parties. Neither the OTS nor any other state agency was party to the Flaggs' contract with Yonkers. There was no OTS-Yonkers joint enterprise; and no state function was delegated to Yonkers as a mortgagor. In short, Yonkers was a private entity participating in a regulated field of activity. Yonkers's actions were consistent with the law, to be sure, but obedience to the law alone does not create a sufficient nexus with the state to sustain a finding of "state action."

We have reviewed all of appellants' remaining arguments and find each of them to be without merit. For the foregoing reasons, the judgment of the District Court is AFFIRMED.

APPENDIX B — OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED MARCH 8, 2004

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

03 CIV. 5133 (WCC)

HANS W. FLAGG and EILEEN S. FLAGG, on behalf of themselves and all others similarly situated,

Plaintiffs,

-against-

YONKERS SAVINGS AND LOAN ASSOCIATION, FA (a/k/a Yonkers Financial),

Defendant.

OPINION AND ORDER

CONNER, Sr. D.J.:

Plaintiffs Hans W. Flagg and Eileen S. Flagg, on behalf of themselves and all others similarly situated, bring this action against defendant Yonkers Savings and Loan Association, a/k/a Yonkers Financial ("Yonkers"),[1] seeking

1. Defendant is a federal savings and loan association with its principal office in Yonkers, New York. (Complt.¶ 7.) It was acquired by Atlantic Bank of New York ("Atlantic Bank") in May 2002 as the result of a merger between Atlantic Bank and defendant's holding company parent, Yonkers Financial Corporation. (*Id.*)

declarations: (1) pursuant to 28 U.S.C. § 2201 that federal law neither preempts nor precludes the applicability of New York statutes requiring the payment of interest on escrow accounts; (2) pursuant to 28 U.S.C. § 2202 that defendant's actions in connection with the mortgages of plaintiffs and the putative class violated N.Y. GEN. OBLIG. LAW § 5-601; GEN. BUS. LAW § 349, BANKING LAW §§ 14-b and 6-k, REAL PROP. TAX LAW § 953(2) and constitute breach of contract and unjust enrichment; and (3) pursuant to 28 U.S.C. § 2202 that plaintiffs and the putative class are entitled to compensatory damages or disgorgement or restitution in an amount to be determined at trial.[2] In the alternative, should this Court hold that the federal regulations preempt the state statutes, plaintiffs seek a declaration that the federal regulations constitute a taking under the Fifth Amendment that entitles them to just compensation. Plaintiffs also seek certification of this case as a class action pursuant to Fed. R. Civ. P. 23 with plaintiffs certified as class representatives.[3] Defendant has moved pursuant to Fed. R. Civ. P. 12(b)(6) to dismiss the Complaint with prejudice for failure to state a claim on which relief can be granted. Plaintiffs have cross moved pursuant to Fed. R. Civ. P. 56 and 23 for summary judgment and class certification. For the reasons set forth herein, we grant defendant's Rule 12(b)(6) motion to dismiss

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2. This Court has subject matter jurisdiction pursuant to 28 U.S.C. §§ 1331, 1367 and 2201-02.

3. We reserve judgment on the class certification issue because we need reach it only if plaintiffs establish a basis for defendant's liability under either the New York statutes or the Fifth Amendment.

the Complaint with prejudice and deny as moot plaintiffs' Rule 56 cross motion for summary judgment.[4]

BACKGROUND

The facts underlying this dispute are simple and undisputed. Plaintiffs entered into a mortgage contract with defendant on June 12, 1998, in connection with a loan on their residence in Scarsdale, New York. (Pls. Rule 56.1 Stmt. ¶ 1; Complt. ¶ 6.) That contract included a provision governing funds held in escrow by defendant to pay for, inter alia, taxes, assessments and insurance, entitled "Lender's Obligations." (Pls. Rule 56.1 Stmt. ¶ 2.) This provision provides in relevant part:

> Lender will not be required to pay me any interest or earnings on the funds unless either (i) Lender and I agree in writing, at the time I sign this Security Instrument, that Lender will pay interest on the Funds; or (ii) the law requires Lender to pay interest on the Funds.

With respect to the governing law, the mortgage agreement states:

> *This Security Instrument is governed by federal law and the law that applies in the place*

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4. *See Westchester Day Sch. v. Vill. of Mamaroneck,* 236 F.Supp.2d 349, 351 (S.D.N.Y.2002) (Conner, J.) ("[P]laintiff's motion for partial summary judgment is granted, thereby rendering moot defendants' motion to dismiss.").

> *where the Property is located.* If any term of this Security Instrument or of the Note conflicts with the law, all other terms of this Security Instrument and of the Note will remain in effect if they can be given effect without the conflicting term. This means that any terms of this Security Instrument and of the Note which conflict with the law can be separated from the remaining terms, and the remaining terms will still be enforced.

(Pls. Rule 56.1 Stmt. ¶ 3 (emphasis added).) Pursuant to this agreement, plaintiffs deposited more than $4,000 into the escrow account with defendant at the time that their loan closed, and the balance of that account sometimes exceeded $6,000 during the life of that loan. (*Id.* ¶ 4.) Defendant never paid plaintiffs interest on that account before Yonkers merged with Atlantic Bank in May 2002. (*Id.* ¶ 5.) After the merger, Atlantic Bank began to pay plaintiffs interest on their escrow account. (*Id.* ¶ 6.)

DISCUSSION

I. *Standard of Review*

On a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6), the court must accept as true all of the well pleaded facts and consider those facts in the light most favorable to the plaintiff. *See Warth v. Seldin,* 422 U.S. 490, 501 (1975); *Hertz Corp. v. City of New York,* 1 F.3d 121, 125 (2d Cir.1993); *In re AES Corp. Sec. Litig.,* 825 F.Supp. 578, 583 (S.D.N.Y.1993) (Conner, J.). On such a motion, the issue is "whether the claimant is entitled to offer evidence to support

the claims." *Scheuer v. Rhodes,* 416 U.S. 232, 236 (1974), *overruled on other grounds by Davis v. Scherer,* 468 U.S. 183 (1984). A complaint should not be dismissed for failure to state a claim "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Padavan v. United States,* 82 F.3d 23, 26 (2d Cir.1996) (quoting *Hughes v. Rowe,* 449 U.S. 5, 10 (1980)). Generally, "[c]onclusory allegations or legal conclusions masquerading as factual conclusions will not suffice to prevent a motion to dismiss." 2 James Wm. Moore et al., Moore's Federal Practice § 12.34[1][b] (3d ed.1997); *see also Hirsch v. Arthur Andersen & Co.,* 72 F.3d 1085, 1088 (2d Cir.1995). Allegations that are so conclusory that they fail to give notice of the basic events and circumstances of which the plaintiff complains, are insufficient as a matter of law. *See Martin v. N.Y. State Dep't of Mental Hygiene,* 588 F.2d 371, 372 (2d Cir.1978).

II. *Whether the New York Escrow Account Interest Statutes are Preempted*

Defendant claims that regulations implemented by the Office of Thrift Supervision ("OTS") pursuant to the Home Owners Loan Act, 12 U.S.C. § 1464(a) (the "HOLA Regulations") preempt those New York state statutes that require the payment of interest on escrow funds because those regulations completely occupy the field of regulating federal savings associations and do not require interest payments in the absence of a written agreement to that effect. (Def. Mem. Supp. Mot. Dismiss at 4, 8.) Defendant also claims that the preemptive effect of these regulations is not vitiated by the

Appendix B

Real Estate Settlement Procedures Act of 1974 ("RESPA"). (*Id.* at 10.) Plaintiffs contend otherwise. We begin our analysis with a review of the statutes and regulations at issue.

A. *Review of the State and Federal Statutes and Regulations at Issue*

The HOLA Regulations are promulgated pursuant to 12 U.S.C. §§ 1463(a)[5] and 1464(a).[6] With respect to federal

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5. 12 U.S.C. § 1463 governs the supervision of federal savings associations and provides in relevant part: "The Director [of the Office of Thrift Supervision] may issue such regulations as the Director determines to be appropriate to carry out the responsibilities of the Director or the Office." *Id.* § 1463(a)(2).

6. 12 U.S.C. § 1464(a) provides:

> In order to provide thrift institutions for the deposit of funds and for the extension of credit for homes and other goods and services, the Director is authorized, under such regulations as the Director may prescribe—
>
> (1) to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as Federal savings associations (including Federal savings banks), and
>
> (2) to issue charters therefor, giving primary consideration of the best practices of thrift institutions in the United States. The lending and investment powers conferred by this section are intended to encourage such institutions to provide credit for housing safely and soundly.

preemption as to the operation of federal savings associations, 12 C.F.R. § 545.2 provides generally:

> The regulations in this Part 545 are promulgated pursuant to the plenary and exclusive authority of the Office to regulate all aspects of the operations of Federal savings associations, as set forth in section 5(a) of the Act. *This exercise of the Office's authority is preemptive of any state law purporting to address the subject of the operations of a Federal savings association.*

Id. (emphasis added). The HOLA Regulation governing preemption with respect to the lending and investment practices of federal savings associations is 12 C.F.R. § 560.2(a), which provides:

> Pursuant to sections 4(a) and 5(a) of the HOLA, 12 U.S.C. 1463(a), 1464(a), OTS is authorized to promulgate regulations that preempt state laws affecting the operations of federal savings associations when deemed appropriate to facilitate the safe and sound operation of federal savings associations, to enable federal savings associations to conduct their operations in accordance with the best practices of thrift institutions in the United States, or to further other purposes of the HOLA. *To enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices (by efficiently delivering low-cost credit to the public free from*

> *undue regulatory duplication and burden), OTS hereby occupies the entire field of lending regulation for federal savings associations.* OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation. *Accordingly, federal savings associations may extend credit as authorized under federal law, including this part, without regard to state laws purporting to regulate or otherwise affect their credit activities,* except to the extent provided in paragraph (c) of this section or § 560.110 of this part.[7] For purposes of this section, "state law" includes any state statute, regulation, ruling, order or judicial decision.

Id. (emphasis added). Section 560.2 also provides "illustrative examples" of "the types of state laws preempted by paragraph (a) of this section" and states that they "*include, without limitation,* state laws purporting to impose requirements regarding . . . *Escrow accounts,* impound accounts, and similar accounts." *Id.* § 560.2(b)(6) (emphasis added). Section 560.2 then sets forth a list of state laws that are *not* preempted; this list does not mention escrow accounts or other laws relating to interest. *See id.* § 560.2(c).[8] This

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7. 12 C.F.R. § 560.110 is entitled "Most Favored Lender Usury Preemption" and is not relevant in the present case.

8. Specifically, 12 C.F.R. § 560.2(c) provides:

> State laws of the following types are not preempted to the extent that they only incidentally affect the lending

(Cont'd)

chapter does not contain a regulation specifically requiring the payment of interest by lenders on funds held in escrow accounts.

New York has, however, several state statutes governing mortgage lending institutions that do require the payment of interest on escrow accounts. N.Y. GEN. OBLIG. LAW § 5-601 provides in relevant part:

> Any mortgage investing institution which maintains an escrow account pursuant to any agreement executed in connection with a mortgage

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(Cont'd)

> operations of Federal savings associations or are otherwise consistent with the purposes of paragraph (a) of this section:
>
> (1) Contract and commercial law;
>
> (2) Real property law;
>
> (3) Homestead laws specified in 12 U.S.C. 1462a(f);
>
> (4) Tort law;
>
> (5) Criminal law; and
>
> (6) Any other law that OTS, upon review, finds:
>
> (i) Furthers a vital state interest; and
>
> (ii) Either has only an incidental effect on lending operations or is not otherwise contrary to the purposes expressed in paragraph (a) of this section.

> on any one to six family residence occupied by the owner or on any property owned by a cooperative apartment corporation, . . . located in this state shall, for each quarterly period in which such escrow account is established, credit the same with dividends or interest at a rate of not less than two per centum per year based on the average of the sums so paid for the average length of time on deposit or a rate prescribed by the banking board pursuant to section fourteen-b of the banking law and pursuant to the terms and conditions set forth in that section whichever is higher. The banking board shall prescribe by regulation the method or basis of computing any minimum rate of interest required by this section and any such minimum rate shall be a net rate over and above any service charge that may be imposed by any mortgage lending institution for maintaining an escrow account....

With respect to specific escrow accounts, N.Y. Real Prop. Tax Law § 953 prescribes the duties and responsibilities of mortgage investing institutions concerning real property tax escrow accounts and provides, inter alia, that:

> Every mortgage investing institution subject to the provisions of section fourteen-b of the banking law shall pay at least the minimum rate of interest on each real property tax escrow account as prescribed therein except that any such mortgage investing institution shall not be

> required to pay such minimum rate of interest on real property tax escrow accounts established for non-mortgagors.

Id. § 953(2). N.Y. Banking Law § 6-k(2)(b) governs the duties of mortgage investing institutions relating to real property insurance escrow accounts and provides that "[every mortgage investing institution shall pay at least the minimum rate of interest on each real property insurance escrow account as prescribed therein]." The interest rates to be paid under these state escrow provisions are set by the state banking board pursuant to procedures set forth in N.Y. Banking Law § 14-b.[9]

B. ***Preemption Analysis***

"Within constitutional limits, federal preemption of state law is found where Congress has explicitly expressed its intent to preempt, or where the nature and object of the federal

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9. Section 14-b also defines the term "mortgage investing institution" as utilized in that section and in N.Y. GEN. OBLIG. LAW § 5-601; the definition encompasses a variety of financial institutions, including "federal savings and loan association . . . which makes, extends or holds a mortgage on any one to six family residence occupied by the owner or any property owned by a cooperative apartment corporation . . . located in this state." *Id.* § 14-b(5). Section 14-b defines "escrow account" as "any account established pursuant to an agreement between a mortgagor and a mortgage investing institution whereby the mortgagor pays to the mortgage investing institution or his designee amounts to be used for the payment of insurance premiums, water rents or any similar charges, and shall also include real property tax escrow accounts as defined in title three-A of article nine of the real property tax law." *Id.* § 14-b(6).

laws and regulatory scheme show Congress' intent to occupy the entire field." *Ingham Micro, Inc. v. Airborne Cargo Exp., Inc.,* 154 F.Supp.2d 834, 838 (S.D.N.Y.2001). The Second Circuit has described the Supremacy Clause origin of the preemption doctrines:

> The Supremacy Clause of the United States Constitution provides that "[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land." U.S. CONST. art. VI, cl. 2. State law is preempted explicitly where Congress states an intent to occupy a field and to exclude state regulation. State law is preempted implicitly where the federal interest in the subject matter regulated is so pervasive that no room remains for state action, indicating an implicit intent to occupy the field, or where the state regulation at issue conflicts with federal law or stands as an obstacle to the accomplishment of its objectives.

Rondout Elec., Inc. v. N.Y. State Dep't of Labor, 335 F.3d 162, 166 (2d Cir.2003) (citing, inter alia, *Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta,* 458 U.S. 141, 153 (1982)), *cert. denied,* 124 S.Ct. 1045 (2004). Moreover, "[f]ederal law may preempt state regulation in whole or in part." *Id.*

"Federal regulations have no less preemptive effect than federal statutes." *de la Cuesta,* 458 U.S. at 153. When Congress "has directed an administrator to exercise his discretion, his judgments are subject to judicial review only

to determine whether he has exceeded his statutory authority or acted arbitrarily." *Id.* at 153-54. This limited inquiry applies to regulations promulgated with the intention of preempting state law. *Id.* at 154. Thus, if the administrator's "'choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, [the courts] should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned.'" *Id.* (quoting *United States v. Shimer,* 367 U.S. 374, 383 (1961)). Finally, a "pre-emptive regulation's force does not depend on express congressional authorization to displace state law; moreover, whether the administrator failed to exercise an option to promulgate regulations which did not disturb state law is not dispositive." *Id.*

In determining whether the HOLA Regulations preempt state law, we must consider "whether the regulations evidence a desire to occupy a field completely. . . . Pre-emption, [however], should not be inferred, however, simply because the agency's regulations are comprehensive." *R.J. Reynolds Tobacco Co. v. Durham County, N.C.,* 479 U.S. 130, 149 (1986) (citations omitted) (citing *de la Cuesta,* 458 U.S. at 153-54, and *Hillsborough County v. Automated Med. Labs., Inc.,* 471 U.S. 707, 716-18 (1985)) (noting that "the present statutes and regulations that guide this monitoring and the warehouse proprietor's own conduct with respect to the imported goods are not so comprehensive as to leave no room for North Carolina's assessment of ad valorem taxes" in concluding that Congress has not "exercised its power under the Supremacy Clause to pre-empt ad valorem state taxation of imported goods that are stored in customs-bonded

warehouses and that are destined for domestic markets"). Moreover, "as long as a federal statute contains an express preemption clause, it is wholly unnecessary and inappropriate to import notions of implied preemption through conflict into the express preemption analysis." *Dow Agrosciences LLC v. Bates,* 332 F.3d 323, 329-30 (5th Cir.2003) (footnotes omitted) (discussing *Cipollone v. Liggett Group, Inc.,* 505 U.S. 504, 517, 531-32, 544 (1992) (plurality opinion)), *petition for cert. filed,* 72 U.S.L.W. 3184 (U.S. Sept. 9, 2003) (No. 03-388). Thus, if the legislation includes a specific preemption provision, "'the Court's task is one of statutory interpretation—only to identify the domain expressly preempted by the provision.'" *Dow Agrosciences,* 332 F.3d at 330 n.12 (quoting *Cipollone,* 505 U.S. at 532 (Blackmun, J., concurring in part and dissenting in part)).

Defendant, citing the preamble to the HOLA Regulations and several opinion letters authored by OTS's chief counsel, claims that the HOLA Regulations preempt the New York escrow statutes because they expressly occupy the entire field of lending by federal associations and leave the payment of interest on escrow accounts to be governed by the loan agreement. (Def. Mem. Supp. Mot. Dismiss at 4-6, 8.) In response, plaintiffs claim that the regulations, preamble and interpretive letters are unreasonable as applied and entitled to no deference because the HOLA Regulations could not occupy the entire field since they do not include a regulation governing the payment of interest in connection with escrow accounts and specifically defer to RESPA with respect to such accounts. (Pls. Mem. Supp. Summ. J. at 9-11, 16.) We conclude that the New York escrow account interest statutes are preempted because the HOLA Regulations occupy the entire field of governing federal loan associations.

Appendix B

1. *The Preemptive Language of the Regulations*

Occupation of the entire field is primarily evinced by the plain text of the applicable regulations. For example, 12 C.F.R. § 560.2(a), the Regulation that governs federal preemption in the lending and investment practices of federal savings associations,[10] states explicitly that it "*occupies the entire field* of lending regulation for federal savings associations" and that such associations "may extend credit without regard to state laws purporting to regulate or otherwise affect their credit activities." *Id.* (emphasis added). Indeed, as stated previously, the express exemptions from preemption under this regulation are indisputably inapplicable in the present case. *See supra* notes 7-8. Most tellingly, state laws pertaining to escrow accounts are explicitly included as an "illustrative example" of state laws that are preempted by the OTS regulations. *Id.* § 560.2(b).

2. *The Preamble and the Regulatory History*

This evidence of OTS's preemptive intent is further reinforced by the preamble to 12 C.F.R. § 560.2, as published in the Federal Register. According to the preamble, § 560.2 was intended to "set[ ] forth OTS's longstanding position, as developed in case law and legal opinions by both OTS and its predecessor, the FHLBB,[11] and as reflected in

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10. Section 560.2 is related to, but distinct from § 545.2, which is the regulation that governs preemption of state laws in the general operation of federal savings associations. *See supra* Part II.A.

11. FHLBB is the abbreviation for Federal Home Loan Bank Board.

§ 545.2, on the federal preemption of state laws affecting the lending activities of federal savings associations." It was promulgated when OTS moved "its lending regulations out of Part 545 and, thus, separate[d] them from its general preemption regulation, § 545.2." OTS Final Rule, 61 Fed.Reg. 50,951, 50,965 (Sept. 30, 1996) (codified at 12 C.F.R. pts. 545, 556, 560, 563, 566, 571 and 590). Indeed, the new preemption regulation was expressly intended "to confirm and carry forward [OTS's] existing preemption position." *Id.*

Substantively, the HOLA Regulations are silent on the topic of the payment of interest on escrow accounts. This silence is by design; in 1983, the FHLBB promulgated regulations that "remove[d] the [existing] substantive provisions pertaining to escrow accounts, allowing such matters to be governed by the loan contract, and in their place require a more detailed disclosure about the accounts." Rules and Regulations of Federal Home Loan Bank Board, 48 Fed.Reg. 23,032, 23,039 (May 23, 1983) (codified at 12 C.F.R. pts. 523, 526, 541, 545, 555, 561 and 563). Among these deleted provisions was a section requiring the payment of interest on escrow accounts by lenders if the state wherein the security dwelling was located had a statute requiring such payments. *See First Fed. Sav. & Loan Ass'n v. Greenwald,* 591 F.2d 417, 420 n.3 (1st Cir.1979) (describing previous regulation). That provision was deleted because the 1983 revision "only referenc[es] the requirements of RESPA" and allows lenders to "require escrow accounts to the extent agreed to in the loan contract," subject to new disclosure requirements as to the escrow account's purpose, computation of amount paid and the rights of the lender if the borrower

fails to make escrow payments. Rules and Regulations of Federal Home Loan Bank Board, 48 Fed.Reg. at 23,039.

3. *Agency Interpretations of the HOLA Regulations*

Moreover, our conclusion is consistent with the position that OTS has taken with respect to the broad preemptive effect of the HOLA Regulations on other matters. Indeed, in 1991, OTS concluded that N.Y. REAL PROP. TAX LAW § 953, a statute at issue in this case, *see supra* Part II.A., was preempted by the more general preemption statement of 12 C.F.R. § 545.2 "insofar as it purports to regulate interest payments, service charges, and the disclosure of information on escrow accounts for mortgages between Federal savings associations and their borrowers." Opinion Letter by Chief Counsel Harris Weinstein, at 1 (Jan. 3, 1991). That letter noted the regulatory history of the 1983 revision, and concluded that "escrow accounts on mortgage loans are among the operations of federal savings associations that are governed *solely* by federal law." *Id.* at 3-4. Moreover, OTS has continued to endorse a construction that gives broad preemptive effect to the HOLA Regulations.[12] *See* Opinion Letter by Chief

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12. Defendant has submitted an Opinion Letter by the Chief Counsel of OTS commenting directly on the present case and concluding that there is no obligation to pay interest because the HOLA Regulations preempt the New York escrow statutes, a result not changed by the choice of law provision in the mortgage. *See* Opinion Letter by Chief Counsel Carolyn J. Buck, at 5 (Oct. 6, 2003). This letter was drafted in response to a request by defendant's counsel for concurrence in a detailed analysis that was provided to OTS, along with a copy of the letter from plaintiffs' counsel to the Court

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Counsel Carolyn J. Buck, at 17-18 (Mar. 10, 1999) (relying on 12 C.F.R. § 560.2 and examples cited therein to conclude that the HOLA Regulations preempt application of the broad provisions of the California Unfair Competition Act in a manner that would apply to federally chartered loan associations' advertising, forced placement of hazard insurance and charging of loan-related fees); Opinion Letter by Chief Counsel Carolyn J. Buck, at 1 (Dec. 24, 1996) (concluding with respect to credit card issuance by federally chartered savings association that "federal law does not preempt the cited Indiana law prohibiting fraudulent and deceptive loan practices" but does preempt Indiana statutes that "pertain to disclosure and loan-related charges" that are within the purview of § 560.2). "An agency's consistent interpretation of its regulations is to be given controlling weight unless plainly erroneous or inconsistent with the regulation." *Taylor v. Vt. Dep't of Educ.*, 313 F.3d 768, 780 (2d Cir.2002). Moreover, this deference extends to interpretive positions taken in opinion or policy letters issued by the agency. *See id.* at 780 n.7. Given the preemptive language of 12 C.F.R. § 560.2 and the various examples discussed therein, OTS's construction of that language is

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advising us of the grounds, including RESPA, for their summary judgment motion. (Weinstein Decl., Exs. 9-10.) Although we are entitled to give deference even to those agency interpretations that arise directly out of the present litigation, *see, e.g., Barnhart v. Walton,* 535 U.S. 212, 221 (2002), we decline to give weight to the letter in this case because it does not address the impact of RESPA on plaintiffs' contentions and thus fails to consider plaintiffs' principal argument against the federal preemption of the New York statutes. *See also infra* Part II.C.

neither inconsistent nor plainly erroneous, and thus is entitled to deference by this Court. Indeed, our conclusion is in accord with *Wis. League of Fin. Insts., Ltd. v. Galecki,* 707 F.Supp. 401 (W.D.Wis.1989), wherein the court concluded that a Wisconsin state statute requiring lenders, including federally chartered savings institutions, to pay interest on escrow accounts was preempted explicitly by the statement in 12 C.F.R. § 545.2 and implicitly by the structure and purpose of the federal regulations, which was to create flexibility in the negotiation of escrow arrangements. *Id.* at 404-06. Accordingly, we disagree with plaintiffs' contention that OTS cannot occupy a field wherein it has not issued specific regulations (Pls. Mem. Supp. Summ. J. at 11) and we conclude that the New York escrow account interest statutes are preempted by the HOLA Regulations.

C. *Whether Preemption is Consistent with the HOLA and RESPA Statutes*

Plaintiffs claim, however, that this preemptive effect is inconsistent with both HOLA and RESPA, to which OTS has deferred with respect to escrow accounts. (Pls. Mem. Supp. Summ. J. at 12-13.) We address each claim in turn.

1. *Whether the HOLA Regulations are Consistent with HOLA*

With respect to HOLA, plaintiffs cite 12 U.S.C. § 1464(n)(1), and claim that HOLA specifically subjects federal savings associations to state laws. Section 1464(n) governs federal savings associations acting as trustees or in

other fiduciary capacities. In particular, § 1464(n)(1) describes the applicable permitting process:

> The Director may grant by special permit to a Federal savings association applying therefor the right to act as trustee, executor, administrator, guardian, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which compete with Federal savings associations are permitted to act under the laws of the State in which the Federal savings association is located. Subject to the regulations of the Director, service corporations may invest in State or federally chartered corporations which are located in the State in which the home office of the Federal savings association is located and which are engaged in trust activities.

Furthermore, plaintiffs cite *Jamaica Sav. Bank v. Lefkowitz,* 390 F.Supp. 1357 (E.D.N.Y.), *aff'd without opinion,* 423 U.S. 802 (1975), in support of the proposition that a "federal savings association is acting as a 'trustee . . . or in [another] fiduciary capacity' in connection with the escrow deposits of plaintiffs and the Class," and thus is subject to the same rights and conditions as state associations under § 1464(n)(1). (Pls. Mem. Supp. Summ. J. at 12-13.)

We conclude that § 1464(n)(1) does not subject federal savings associations to state laws with respect to the payment of interest on escrow accounts. We do not read the language of that subsection as imposing any specific substantive state law standards on the conduct of federal savings associations

acting as fiduciaries. Our reading is further reinforced because § 1464(n) contains other subsections that *do* in fact affirmatively and expressly direct federal savings institutions to follow state laws with respect to deposits and oaths and affidavits, namely, § 1464(n)(5)[13] and § 1464(n)(6).[14] Moreover, the section of *Jamaica Savings Bank* cited by plaintiffs is inapposite because it does not relate to a preemption issue; rather, it concluded that the New York escrow account interest statutes did not amount to an

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13. Section 1464(n)(5) provides:

> Whenever the laws of a State require corporations acting in a fiduciary capacity to deposit securities with the State authorities for the protection of private or court trusts, Federal savings associations so acting shall be required to make similar deposits. Securities so deposited shall be held for the protection of private or court trusts, as provided by the State law. Federal savings associations in such cases shall not be required to execute the bond usually required of individuals if State corporations under similar circumstances are exempt from this requirement. Federal savings associations shall have power to execute such bond when so required by the laws of the State involved.

14. Section 1464(n)(6) provides:

> In any case in which the laws of a State require that a corporation acting as trustee, executor, administrator, or in any capacity specified in this section, shall take an oath or make an affidavit, the president, vice president, cashier, or trust officer of such association may take the necessary oath or execute the necessary affidavit.

unconstitutional taking because the bank "did not obtain an ultimate beneficial interest in the funds for itself," but nevertheless realized profits from their investment that should be shared with mortgagors. 390 F.Supp. at 1363. Accordingly, we conclude that the HOLA Regulations are not inconsistent with the HOLA statute.

2. *Whether the HOLA Regulations are Consistent with RESPA*

We next turn to plaintiffs' claim that the HOLA Regulations are inconsistent with RESPA because regulations promulgated pursuant to that Act: (1) apply to post-closing obligations such as interest payments on escrow accounts; and (2) incorporate state escrow statutes that provide greater consumer protection, such as New York's escrow account interest laws. (Pls. Mem. Supp. Summ. J. at 4-9.) Defendant contends that RESPA does not blunt the preemptive effect of the HOLA Regulations because the payment of interest on escrow accounts is not a "settlement practice" under RESPA. (Def. Mem. Supp. Mot. Dismiss at 10.) Accordingly, we first address the purpose and scope of RESPA.

As stated in 12 U.S.C. § 2601, Congress enacted RESPA because:

> (a) The Congress finds that significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from

> unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country. . . .
>
> (b) It is the purpose of this chapter to effect certain changes in the settlement process for residential real estate that will result—
>
> (1) in more effective advance disclosure to home buyers and sellers of settlement costs;
>
> (2) in the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services;
>
> (3) in a reduction in the amounts home buyers are required to place in escrow accounts established to insure the payment of real estate taxes and insurance; and
>
> (4) in significant reform and modernization of local recordkeeping of land title information.

With respect to escrow accounts, RESPA provides limitations on the amount that lenders can require borrowers or prospective borrowers to deposit into escrow accounts and requires loan servicers to provide borrowers with account statements and notifications of shortages. *See* 12 U.S.C.

§ 2609. This provision is, however, silent about the payment of interest. Finally, RESPA contains a savings provision describing its interaction with state laws governing real estate settlement practices, and expressly allowing state laws to provide consumer protections greater than those contained therein:

> This chapter does not annul, alter, or affect, or exempt any person subject to the provisions of this chapter from complying with, the laws of any State with respect to settlement practices, except to the extent that those laws are inconsistent with any provision of this chapter, and then only to the extent of the inconsistency. The Secretary is authorized to determine whether such inconsistencies exist. *The Secretary may not determine that any State law is inconsistent with any provision of this chapter if the Secretary determines that such law gives greater protection to the consumer.* In making these determinations the Secretary shall consult with the appropriate Federal agencies.

12 U.S.C. § 2616 (emphasis added).

Accordingly, plaintiffs claim that the payment of interest on escrow accounts is a "settlement practice" under RESPA and therefore the Secretary may not preempt the New York law that gives greater protection to the consumer. "Settlement *practice* " is not a term defined in RESPA's definitions

section, 12 U.S.C. § 2602. The definitions section does, however, define the term "settlement services" to include:

> any service provided in connection with a real estate settlement including, but not limited to, the following: title searches, title examinations, the provision of title certificates, title insurance, services rendered by an attorney, the preparation of documents, property surveys, the rendering of credit reports or appraisals, pest and fungus inspections, services rendered by a real estate agent or broker, the origination of a federally related mortgage loan (including, but not limited to, the taking of loan applications, loan processing, and the underwriting and funding of loans), and the handling of the processing, and closing or settlement.

12 U.S.C. § 2602(3). The First Circuit has concluded that the payment of interest on escrow accounts is not a "settlement practice" within the scope of RESPA and that its savings clause did not bar preemption of state laws[15] requiring such payments. *Greenwald,* 591 F.2d at 426. Although the First Circuit did not explicate its reasoning, the district court

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15. *Greenwald* 's preemption ruling was the result of an actual conflict analysis that stemmed from the existence of a since-deleted HOLA regulation governing the payment of interest on escrow accounts, rather than the broader "occupying the field" conclusion utilized in this Opinion and Order. 591 F.2d at 425-26. The RESPA analysis is, however, equally applicable because, as is discussed *infra,* RESPA has no provision specifically concerning the payment of interest on escrow accounts.

in that case engaged in a temporal analysis that concluded that "interest payment on tax escrow accounts, which can continue long after the closing of the mortgage transaction and which can continue to occur during the entire life of the mortgage, is obviously not a settlement practice within the meaning of the statute." *Greenwald v. First Fed. Sav. & Loan Ass'n,* 446 F.Supp. 620, 625 (D.Mass.1978).

Plaintiffs claim that the *Greenwald* temporal analysis is both legally incorrect and, in any event, rendered obsolete by the 1990 enactment of 12 U.S.C. § 2605(g). (Pls. Mem. Supp. Summ. J. at 5-6.) They contend that § 2605(g), as well as § 2609(a)(2), which existed at the time of the *Greenwald* decision, evince Congress's desire to extend "settlement practices" with respect to escrow accounts past the initial closing. In response, defendant relies on the *Greenwald* analysis with respect to RESPA's applicability, but also claims that RESPA was a remedial statute intended to improve disclosure and prohibit abusive practices, not to impose on lenders ne substantive obligations such as the payment of interest on escrow accounts. (Def. Mem. Supp. Mot. Dismiss at 11; Def. Reply Mem. Supp. Mot. Dismiss at 6.)

12 U.S.C. § 2605(g) provides:

> If the terms of any federally related mortgage loan require the borrower to make payments to the servicer of the loan for deposit into an escrow account for the purpose of assuring payment of taxes, insurance premiums, and other charges with respect to the property, *the servicer shall make payments from the escrow account for such taxes,*

> *insurance premiums, and other charges in a timely manner as such payments become due.*

Section 2609(a)(2) governs the amount that the lender may require that the borrower place into escrow. It provides:

> A lender, in connection with a federally related mortgage loan, may not require the borrower or prospective borrower . . . to deposit in any such escrow account in any month beginning with the first full installment payment under the mortgage a sum (for the purpose of assuring payment of taxes, insurance premiums and other charges with respect to the property) in excess of the sum of (A) one-twelfth of the total amount of the estimated taxes, insurance premiums and other charges which are reasonably anticipated to be paid on dates during the ensuing twelve months which dates are in accordance with the normal lending practice of the lender and local custom, provided that the selection of each such date constitutes prudent lending practice, plus (B) such amount as is necessary to maintain an additional balance in such escrow account not to exceed one-sixth of the estimated total amount of such taxes, insurance premiums and other charges to be paid on dates, as provided above, during the ensuing twelve-month period: *Provided, however,* That in the event the lender determines there will be or is a deficiency he shall not be prohibited from requiring additional monthly deposits in such

> escrow account to avoid or eliminate such deficiency.

12 U.S.C. § 2609(a)(2).

We begin by noting that, in a relatively recent opinion, the Ninth Circuit has approved *Greenwald* 's temporal "at or before settlement" approach to the scope of RESPA's applicability in the context of whether a lender is required to disclose the possibility that demand and reconveyance fees will be assessed in the future. *See Bloom v. Martin,* 77 F.3d 318, 321 (9th Cir.1996). We, conclude, however, that the *Greenwald* temporal analysis lacks continuing viability in the context of escrow accounts because §§ 2605 and 2609 impose obligations on lenders that extend beyond the date of the closing. Indeed, an Illinois federal district court has noted that "RESPA applies not only to the actual settlement process, however, but also to the servicing of federally regulated mortgage loans." *MorEquity, Inc. v. Naeem,* 118 F.Supp.2d 885, 900 (N.D.Ill.2000). Nevertheless, we also conclude that the payment of interest on escrow accounts remains beyond the scope of RESPA, which therefore lends no support for plaintiffs' claim.

Congress enacted RESPA to require lenders to provide better information and disclosure to consumers, thereby protecting them from abusive practices such as, inter alia, unnecessarily high closing and escrow charges. *See* 12 U.S.C. § 2601; *MorEquity,* 118 F.Supp.2d at 900. Put differently, the scope of RESPA ends with the prevention of potentially abusive charges against consumers; it is intended to protect

consumers' present capital.[16] Accordingly, a lender's obligation to pay interest falls outside the scope of RESPA and into the deregulated ambit of the mortgage agreement's terms.[17] We, therefore, conclude that the HOLA Regulations

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16. Plaintiffs argue that the payment of interest on escrow accounts does in fact impact the amount that borrowers are required to pay out-of-pocket into those accounts, and therefore, falls within the ambit of RESPA. (Pls. Reply Mem. Supp. Summ. J. at 3.) In support of this contention, plaintiffs rely on the fact that most lenders who pay interest do so in the form of a direct credit to the borrowers' accounts. (*Id.*) Plaintiffs also rely on the "economic impact" of such payments when they are made by separate check. (*Id.*) We disagree with plaintiffs' arguments because the mechanics of payment are irrelevant; acceptance of their "economic impact" argument conceivably would stretch RESPA to cover every collateral source of income that might affect the amount of out-of-pocket funds that a borrower would need to place into escrow—an interpretation that we decline to adopt.

17. Plaintiffs also argue that it is unreasonable for OTS to make the payment of interest on escrow accounts a matter of separate contractual agreement, rather than regulation because such mortgage agreements are contracts of adhesion offered to borrowers on a "take it or leave it" basis. (Pls. Mem. Supp. Summ. J. at 14-15.) Accepting plaintiffs' representation as true, we nevertheless decline to pass on the reasonableness of the HOLA Regulations because, inasmuch as they are not inconsistent with HOLA or RESPA and there is no claim that they are completely arbitrary, such an inquiry would be an inappropriate judicial intrusion into the administrative rule-making process. *See, e.g., de la Cuesta,* 458 U.S. at 169-70 ("Admittedly, the wisdom of the Board's policy [not banning the use of due-on-sale clauses] is not uncontroverted. But neither is it arbitrary or capricious. As judges, it is neither our function, nor within our expertise, to evaluate the economic soundness of the Board's approach.").

are not inconsistent with RESPA and that they preempt the New York escrow account interest statutes.[18] Accordingly, we grant defendant's motion, deny plaintiffs' cross motion, and dismiss the First Cause of Action in the Complaint seeking a declaration that federal law does not preempt or preclude the applicability of the New York escrow account interest statutes. We also grant defendant's motion, deny plaintiffs' cross motion, and dismiss the Second, Third and Fifth Causes of Action, as they are based on the preempted state statutes.[19]

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18. Plaintiffs, citing the "savings" statute, 12 U.S.C. § 2616 and regulations 24 C.F.R. §§ 3500.17(c)(8) and (d)(1)(C), also claim that RESPA and the regulations promulgated thereunder specifically incorporate state escrow statutes that provide greater consumer protection. (Pls. Mem. Supp. Summ. J. at 8.) Although these regulations clearly incorporate state laws that provide greater consumer protections with respect to the existence of escrow accounts and the amount of money that borrowers must deposit therein, the payment of interest is beyond their scope because like the RESPA statutes, they concern only payments by consumers.

19. Plaintiffs contend that their Third Cause of Action, based on violations of N.Y. Gen. Bus. Law § 349, the deceptive business practices statute, remains viable because defendant's failure to disclose the federal preclusion of the state escrow statutes constitutes failure to disclose a material fact. (Pls. Mem. Supp. Summ. J. at 23-24.) Defendant contends otherwise, and notes that compliance with applicable federal regulations is a compete defense to claims of deceptive business practices under § 349(d). (Def. Mem. Supp. Mot. Dismiss at 19 n. 4.)

Section 349(d) provides that:

> In any such action it shall be a complete defense that the act or practice is, or if in interstate commerce would be,

(Cont'd)

III. *Whether the Mortgage Agreement Requires the Payment of Escrow Interest*

Defendant, relying on *de la Cuesta,* next contends that the mortgage agreement's interest and choice of law clauses did not require it to pay interest on escrow accounts because federal law is the only applicable "law" with respect to whether defendant is required to make such payments. Accordingly, defendant requests dismissal of the Fourth Cause of Action in the Complaint. (Def. Mem. Supp. Mot. Dismiss at 13-14, 19.) Plaintiffs argue in response that, as an ambiguous contract of adhesion, the mortgage agreement should be construed against the lender that drafted it and

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(Cont'd)

> subject to and complies with the rules and regulations of, and the statutes administered by, the federal trade commission or any official department, division, commission or agency of the United States as such rules, regulations or statutes are interpreted by the federal trade commission or such department, division, commission or agency or the federal courts.

We conclude that plaintiffs' action under § 349 fails to state a claim for which relief can be granted because the federal regulations completely preempt the state escrow account interest statutes, and defendant is in compliance with the applicable federal requirements. Moreover, "[c]onsumer fraud claims may not be predicated upon fully disclosed facts," *Negrin v. Norwest Mortgage, Inc.,* 263 A.D.2d 39, 50, 700 N.Y.S.2d 184 (2d Dep't 1999), and "the parties are presumed to have contracted with knowledge of [the] law." *Alexander Muss & Sons v. Rozany,* 170 Misc.2d 890, 891, 655 N.Y.S.2d 238 (1996) (citing *Dolman v. U.S. Trust Co. of N.Y.,* 2 N.Y.2d 110, 116, 138 N.E.2d 784, 157 N.Y.S.2d 537 (1956)).

interpreted as expressly incorporating the New York escrow statutes. (Pls. Mem. Supp. Summ. J. at 18-21.)

As stated previously, the interest provision provides in relevant part:

> Lender will not be required to pay me any interest or earnings on the funds unless either (i) Lender and I agree in writing, at the time I sign this Security Instrument, that Lender will pay interest on the Funds; or (ii) *the law requires Lender to pay interest on the Funds.*

(Pls. Rule 56.1 Stmt. ¶ 3 (emphasis added).) With respect to the governing law, the mortgage agreement states in relevant part that "this Security Instrument is governed by *federal law and the law that applies in the place* where the Property is located." (*Id.* (emphasis added).)

Defendant's contentions present an issue of contract interpretation under New York state law. Contract interpretation presents a question of law for the court if the contract is clear and unambiguous. *See, e.g., United States ex rel. AWL Indus., Inc. v. Site Remediation Servs. Corp.*, 92 F.Supp.2d 132, 135 (E.D.N.Y.2000) (citing *Briarwood Towers 85th Co. v. Guterman,* 136 A.D.2d 456, 458, 523 N.Y.S.2d 98 (1st Dep't 1988)). Moreover, "[w]hether or not a writing is ambiguous is a question of law to be resolved by the courts." *W.W.W. Assocs., Inc. v. Giancontieri,* 77 N.Y.2d 157, 162, 566 N.E.2d 639, 565 N.Y.S.2d 440 (1990). "Where the terms of a contract are ambiguous and susceptible to more than one meaning, the court may consider evidence outside

of the contract as an aid to interpret the meaning of the language that the parties chose." *United States ex rel. AWL Indus.*, 92 F.Supp.2d at 135. "The language at issue will be deemed ambiguous if it is capable of more than one meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement." *Id.* (internal quotation marks omitted).

Residential mortgage agreements such as the contract at issue in the present case frequently are preprinted form contracts of adhesion that are offered by lenders on a "take it or leave it" basis that deprives prospective borrowers the opportunity to negotiate terms effectively. *Jamaica Sav. Bank,* 390 F.Supp. at 1362; *see also In re Parker,* 269 B.R. 522, 530 (D.Vt.2001). Plaintiffs assert, and defendant does not deny, that the mortgage in the present case is such a contract. Accordingly, we will interpret the terms of the agreement in accordance with the standards applicable to contracts of adhesion, and construe it against defendant in case of "doubt or ambiguity." *See, e.g., Jacobson v. Sassower,* 66 N.Y.2d 991, 993, 489 N.E.2d 1283, 499 N.Y.S.2d 381 (1985) ("In cases of doubt or ambiguity, a contract must be construed most strongly against the party who prepared it, and favorably to a party who had no voice in the selection of its language."). Thus, as in the analogous insurance policy context, defendant as drafter has the burden of "establish[ing] that the words and expressions used not only are susceptible of the construction sought by [the drafter] but that it is the only construction which may fairly be placed on them." *Lachs v. Fid. & Cas. Co.*, 306 N.Y. 357, 365, 118 N.E.2d 555 (1954) (construing airline trip insurance policy purchased from vending machine).

Appendix B

New York contract law permits parties to incorporate by reference statutes as terms of their contracts. *See, e.g., Walter H. Poppe Gen. Contracting, Inc. v. Town of Ramapo,* 280 A.D.2d 667, 668, 721 N.Y.S.2d 248 (2d Dep't 2001). Indeed, although the preemption doctrine prohibits parties to a contract from electing to have state law govern over federal law, they nevertheless remain free to include as terms of their agreement state law directives that otherwise would be preempted by federal law. *See, e.g., Wells v. Chevy Chase Bank, F.S.B.,* 377 Md. 197, 224, 231, 832 A.2d 812 (2003) (construing credit card contract referring to state commercial law that had otherwise been preempted by HOLA and noting that "[w]hether the appellants' claims are preempted and whether the appellees contracted to comply with Subtitle 9 are separate and different questions, requiring differing analyses."), *petition for cert. filed,* 72 U.S.L.W. 3451 (U.S. Dec. 22, 2003) (No. 03-918). State laws that become terms of the agreement between the contracting parties are enforceable by a breach of contract action, unless federal law has specifically preempted the breach of contract action as well. *See Am. Airlines, Inc. v. Wolens,* 513 U.S. 219, 233 (1995) (concluding that the preemption provision of the Airline Deregulation Act of 1978 barred state consumer fraud statutory claims against airline, but permitted breach of contract actions based on ticket agreements). State law provisions may be included as contract terms either explicitly as text or incorporated by reference. *Wells,* 377 Md. at 228-29.

A general choice-of-law clause is, however, insufficient as a matter of law to incorporate by reference preempted state laws as the terms of a contract. Holding that "the 'law of the

jurisdiction' includes federal as well as state law," the United States Supreme Court has concluded that parties did not agree to be bound by state or local law with respect to due-on-sale clauses when their agreement contained a provision stating that a "deed is to be governed by the 'law of the jurisdiction' in which the property is located." *de la Cuesta,* 458 U.S. at 158 n.12. The cases following *de la Cuesta* demonstrate that, in order to be considered more than just a general choice-of-law clause, a contract provision purporting to incorporate state law as a contract term must actually cite the relevant state laws to that effect. *Compare Gavey Props./762 v. First Fin. Sav. & Loan Ass'n,* 845 F.2d 519, 523 (5th Cir.1988) (concluding that the parties did not "contract out of the federal provision by specifically choosing Texas law in their loan agreements" when clause stated that "'[i]t is the intention of the parties hereto to conform strictly to the applicable laws of the state of Texas and the United States of America and judicial and/or administrative interpretations thereof regarding the contracting for, charging and receiving of interest for the use of detention of money.'"), *and MorEquity,* 118 F.Supp.2d at 898 n. 5 (concluding that preempted Illinois usury laws did not apply, despite mortgages' choice-of-law provision "indicating that the security interest will be governed by federal law and the law of the jurisdiction in which the property is located"), *with Wells,* 377 Md. at 201, 231-32 (concluding that the parties incorporated by reference state statutes as contract terms when credit card agreement's governing law provision provided that "[t]his Agreement is made in Maryland. It is governed by Subtitle 9 of Title 12 of the Commercial Law

Article of the Maryland Annotated Code and applicable federal laws.").[20]

Construing the choice-of-law provision in the present case against defendant, we conclude that, as a matter of law, that clause is unambiguous and does not in any way evince either party's intent to incorporate the New York escrow statutes into the agreement.[21] A clause providing that the

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20. Indeed, in *Wells*, the Maryland Court of Appeals noted further that:

> It is true that Subtitle 9 is a state law, as defined by 12 C.F.R. § 560.2(a) and, thus, falls within the category of state imposed obligations that regulation preempts. It is not true that Subtitle 9 is required by a state statutory regulation, ruling, order or judicial decision to be complied with in this case. *It is in this case only because the agreement between the parties refer to it and do so in the context of the notice to be given in the event that the agreement is amended.* Indeed, that agreement was prepared by Chevy Chase; it was not imposed on Chevy Chase as a matter of law.

377 Md. at 231 (emphasis added).

21. Plaintiffs state that after Atlantic Bank succeeded Yonkers as their mortgage servicing institution in 2002, Atlantic Bank paid them escrow interest under the same contract both originally and after refinancing. (Pls. Mem. Supp. Summ. J. at 21.) Plaintiffs claim that this action proves that the choice-of-law provision was intended to require the lender to pay interest on escrow accounts. (*Id.*) Assuming the relevance of Atlantic Bank's post-merger actions in divining the intent of its predecessor-in-interest at the time that

(Cont'd)

agreement is "governed by *federal law and the law that applies in the place* where the Property is located," (Pls. Rule 56.1 Stmt. ¶ 3 (emphasis added)), does not have the specificity required as a matter of law to incorporate otherwise preempted state statutes into the mortgage agreement, particularly when the Supremacy Clause implications are taken into account. Permitting such a broad choice-of-law clause to incorporate preempted state statutes as contract terms would defy the reality that the constitutional doctrine of preemption is as meaningful in New York as it is in the other forty-nine states.[22] Accordingly, we grant defendant's motion, deny plaintiffs' cross motion, and dismiss plaintiffs' Fourth Cause of Action.

(Cont'd)

Yonkers entered into the loan agreement with plaintiffs, we cannot consider that subsequent conduct because we have concluded at the outset that the mortgage's choice-of-law clause is unambiguous as a matter of law. *See, e.g., Nat'l Bank of N. N.Y. v. Shaad,* 60 A.D.2d 774, 775, 400 N.Y.S.2d 965 (4th Dep't 1977) ("The language of the security agreements being clear and unambiguous, the subsequent conduct of the parties with respect to the transactions may not be considered for the purpose of varying or contradicting the plain meaning of the agreements."); *accord Hauser v. W. Group Nurseries, Inc.,* 767 F.Supp. 475, 485 (S.D.N.Y.1991).

22. Indeed, the New York legislature recognized the applicability of the preemption doctrine in this context, and specifically conflict preemption. N.Y. Banking Law § 14-b provides in relevant part that "In no event shall interest be required to be paid on escrow accounts where . . . the payment of such interest would violate any federal law or regulation." *Id.* § 14-b(4)(ii).

Appendix B

IV. *Plaintiffs' Fifth Amendment Claim*

Defendant contends that plaintiffs' alternative Fifth Amendment claim should be dismissed because its compliance with federal regulations rendering the payment of interest a matter of private choice does not constitute the state action requisite for a viable Takings Clause claim. (Def. Mem. Supp. Mot. Dismiss at 21-23.) Plaintiffs contend in response that it is the OTS Regulations themselves that are the unconstitutional state action because they take plaintiffs' escrow interest and give it to defendant, and that the taking of interest from the owner of the principal constitutes a taking under the Fifth Amendment. (Pls. Mem. Supp. Summ. J. at 24-25.) We conclude that defendant's failure to pay interest on plaintiffs' escrow account did not violate the Fifth Amendment Takings Clause.

The Takings Clause of the Fifth Amendment to the United State Constitution prohibits a taking of private property for "public use, without just compensation." U.S. CONST., amend. V. It is beyond cavil that governmental action is required to trigger the application of this clause; it does not apply to private parties who are not state or governmental actors. *See, e.g., Fid. Fin. Corp. v. Fed. Home Loan Bank of S.F.,* 792 F.2d 1432, 1435 (9th Cir.1986) (acknowledging issue, but not deciding whether federal home loan bank was a governmental actor for Fifth Amendment purposes), *cert. denied,* 479 U.S. 1064 (1987); *N.Y., N.H. & H.R. Co., First Mortgage 4% Bondholders' Comm. v. United States,* 305 F.Supp. 1049, 1055 (S.D.N.Y.1969), *vacated on other grounds sub. nom., New Haven Inclusion Cases,* 399 U.S. 392 (1970). The state or governmental action

requirement is satisfied if the complained-of conduct is "fairly attributable" to the state. *Am. Mfrs. Mut. Ins. Co. v. Sullivan,* 526 U.S. 40, 50 (1999). In *Cranley v. Nat'l Life Ins. Co. of Vt.,* 318 F.3d 105 (2d Cir.2003), the Second Circuit described the close public-private nexus required for conduct to be "fairly attributable" to the government:

> For the conduct of a private entity to be "fairly attributable" to the state, there must be "such a 'close nexus between the State and the challenged action' that seemingly private behavior 'may be fairly treated as that of the State itself.'" . . . "The purpose of [the close-nexus] requirement is to assure that constitutional standards are invoked only when it can be said that the State is responsible for the specific conduct of which the plaintiff complains." . . .
>
> The determination of whether the specific conduct of which the plaintiff complains constitutes state action is a "necessarily fact-bound inquiry." . . . A challenged activity by a private entity may be deemed state action when the state exercises "coercive power," is "entwined in [the] management or control" of the private actor, or provides the private actor with "significant encouragement, either overt or covert," or when the private actor "operates as a willful participant in joint activity with the State or its agents," is "controlled by an agency of the State," has been delegated a "public function" by the state, or is "entwined with governmental policies." . . .

Id. at 111-12 (citations omitted) (quoting, inter alia, *Brentwood Academy v. Tenn. Secondary Sch. Athletic Ass'n,* 531 U.S. 288, 295 (2001) and *Blum v. Yaretsky,* 457 U.S. 991, 1004 (1982)). A private entity is not, however, "a state actor where its conduct is not compelled by the state but is merely permitted by state law." *Cranley,* 318 F.3d at 112. Indeed, that a corporate entity is chartered by the government does not make it a government actor because "[a]ll corporations act under charters granted by a government" and "[e]ven extensive regulation by the government does not transform the actions of the regulated entity into those of the government." *S.F. Arts & Athletics, Inc. v. United States Olympic Comm.,* 483 U.S. 522, 543-44 (1987).

Indeed, compliance with applicable laws and regulations during the course of corporate conduct does not render a corporation a state actor, even if that conduct causes other parties to suffer some financial or other deprivation. For example, in *San Francisco Arts & Athletics,* the plaintiffs, promoters of the "Gay Olympic Games," claimed that the United States Olympic Committee (the "USOC") enforced the Amateur Sports Act granting it exclusive use of the word "Olympics" and associated symbols in a discriminatory manner that violated the Fifth Amendment's Due Process Clause. 483 U.S. at 543. The Supreme Court held that the USOC was not a governmental actor, despite the fact that it was chartered and partially funded by Congress, and subject

to other congressional requirements. *Id.* The Court concluded that the:

> USOC's choice of how to enforce its exclusive right to use the word "Olympic" simply is not a governmental decision. There is no evidence that the Federal Government coerced or encouraged the USOC in the exercise of its right. At most, the Federal Government, by failing to supervise the USOC's use of its rights, can be said to exercise "[m]ere approval of or acquiescence in the initiatives" of the USOC.

Id. at 547 (alteration in original).

Similarly, in *Cranley,* the Second Circuit held that the reorganization of a domestic mutual insurance company into a stock insurance company, made in accordance with Vermont state insurance laws that required the approval of the insurance commissioner, did not constitute the state action necessary for the plaintiffs to state a claim under the Takings and Contract Clauses.[23] 318 F.3d at 109-10, 112. The court noted that "the State did not instigate the reorganization" and that the commissioner's role was limited to ensuring that the insurance company complied with disclosure requirements and that the reorganization would not prejudice

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23. *See also Tancredi v. Metro. Life Ins. Co.,* 316 F.3d 308, 313 (2d Cir.) (concluding in New York insurance demutualization case that "a regulatory agency's performance of routine oversight functions to ensure that a company's conduct complies with state law does not so entwine the agency in corporate management as to constitute state action"), *cert. denied,* 123 S.Ct. 2610 (2003).

insurance policyholders financially. *Id.* at 112. The Second Circuit stated that the reorganization "plan itself was voluntarily conceived, approved and executed by the management and membership of a private company." *Id.* at 112-13.

We conclude that defendant's failure to pay plaintiffs interest on their mortgage escrow accounts did not constitute a taking in violation of the Fifth Amendment because defendant, although a federally chartered savings and loan, was not a governmental actor. In the present case, defendant's actions constituted a permissible exercise of the options available to it under the applicable federal lending regulations. Indeed, plaintiffs have not submitted any evidence of governmental coercion or encouragement of defendant's conduct in drafting the escrow account interest clause of the mortgage loan agreement.[24] Accordingly, we dismiss plaintiffs' Sixth Cause of Action.

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24. Accordingly, plaintiffs' reliance on *Phillips v. Washington Legal Found.*, 524 U.S. 156 (1998) and *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980), for the proposition that the taking of interest from the owner of the principal by government action is a taking subject to the Fifth Amendment is unavailing because there has been no government action in the present case for purposes of that claim. (Pls. Mem. Supp. Summ. J. at 24-25.)

Appendix B

CONCLUSION

For all of the foregoing reasons, defendant's Rule 12(b)(6) motion to dismiss the Complaint is granted in its entirety without leave to replead and plaintiffs' cross motion for summary judgment pursuant to Rule 56 is denied as moot.[25]

SO ORDERED.

Dated: White Plains, NY
March 8, 2004

s/ William C. Conner
Senior United States District Judge

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25. The issue of liability having been decided entirely in defendant's favor, we need not address plaintiffs' Rule 23 class certification claims.

APPENDIX C — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING PETITION FOR REHEARING FILED FEBRUARY 15, 2005

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
THURGOOD MARSHALL U.S. COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

Roseann B. MacKechnie
CLERK

Date:	2/15/05
Docket Number:	04-1948-cv
Short Title:	Flagg v. Yonkers Savings
DC Docket Number:	03-cv-5133
DC:	SDNY (WHITE PLAINS)
DC Judge:	Honorable William Conner

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, Foley Square, in the City of New York, on the 15th day of February two thousand five.

Present:

Hon. James L. Oakes

Hon. Guido Calabresi

Hon. Chester J. Straub

CIRCUIT JUDGES,

Appendix C

Hans W. Flagg and Eileen S. Flagg, on behalf of themself and all others similarly situated,

Plaintiffs-Appellants,

v

Yonkers Savings and Loan Association, FA, also known as Yonkers Financial,

Defendant-Appellee.

A petition for panel rehearing having been filed herein by Appellants

Upon consideration thereof, it is

Ordered that said petition be and it hereby is **DENIED.**

For the Court,
Roseann B. MacKechnie, Clerk

By: s/ Tracy W. Young
Motion Staff Attorney

APPENDIX D — PRINCIPAL STATUTES AND REGULATIONS INVOLVED

New York General Obligations Law ("GOL") Section 5-601:

> **Interest on deposits in escrow with mortgage investing institutions.** Any mortgage investing institution which maintains an escrow account pursuant to any agreement executed in connection with a mortgage on any one to six family residence occupied by the owner or on any property owned by a cooperative apartment corporation, . . . and located in this state shall, for each quarterly period in which such escrow account is established, credit the same with dividends or interest at a rate of not less than two per centum per year based on the average of the sums so paid for the average length of time on deposit or a rate prescribed by the banking board pursuant to section fourteen-b of the banking law and pursuant to the terms and conditions set forth in that section whichever is higher.

Title 12 United States Code, Section 2616 (RESPA) ("State law unaffected; inconsistant Federal and State provisions"):

> This chapter does not annul, alter, or affect, or exempt any person subject to the provisions of this chapter from complying with, the laws of any State with respect to settlement practices, except to the extent that those laws are inconsistent with any provision of this chapter, and then only to the extent of the inconsistency. The Secretary is authorized to determine whether

such inconsistencies exist. The Secretary may not determine that any State law is inconsistent with any provision of this chapter if the Secretary determines that such law gives greater protection to the consumer.

Title 12 United States Code, Section 1463(a) (Home Owners' Loan Act ("HOLA")):

(a) Federal savings associations

(1) In general

The Director shall provide for the examination, safe and sound operation, and regulation of savings associations.

(2) Regulations

The Director may issue such regulations as the Director determines to be appropriate to carry out the responsibilities of the Director or the Office.

(3) Safe and sound housing credit to be encouraged

The Director shall exercise all powers granted to the Director under this chapter so as to encourage savings associations to provide credit for housing safely and soundly.

Appendix D

Title 12 United State Code, Section 1464(a) (HOLA):

(a) In general

In order to provide thrift institutions for the deposit of funds and for the extension of credit for homes and other goods and services, the Director is authorized, under such regulations as the Director may prescribe --

(1) to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as Federal savings associations (including Federal savings banks), and

(2) to issue charters therefor,

giving primary consideration of the best practices of thrift institutions in the United States. The lending and investment powers conferred by this section are intended to encourage such institutions to provide credit for housing safely and soundly.

12 C.F.R. § 545.2 (OTS Federal Preemption Regulation):

The regulations in this part 545 are promulgated pursuant to the plenary and exclusive authority of the Office to regulate all aspects of the operations of Federal savings associations, as set forth in section 5(a) of the Act. This exercise of

the Office's authority is preemptive of any state law purporting to address the subject of the operations of a Federal savings association.

12 C.F.R. § 560.2 (OTS Occupation of the Field Regulation):

(a) Occupation of field. Pursuant to sections 4(a) and 5(a) of the HOLA, 12 U.S.C. 1463(a), 1464(a), OTS is authorized to promulgate regulations that preempt state laws affecting the operations of federal savings associations when deemed appropriate to facilitate the safe and sound operation of federal savings associations, to enable federal savings associations to conduct their operations in accordance with the best practices of thrift institutions in the United States, or to further other purposes of the HOLA. To enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices (by efficiently delivering low-cost credit to the public free from undue regulatory duplication and burden), OTS hereby occupies the entire field of lending regulation for federal savings associations. OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation. Accordingly, federal savings associations may extend credit as authorized under federal law, including this part, without regard to state laws purporting to regulate or otherwise

affect their credit activities, except to the extent provided in paragraph (c) of this section or Sec. 560.110 of this part. For purposes of this section, "state law" includes any state statute, regulation, ruling, order or judicial decision.

(b) Illustrative examples. Except as provided in Sec. 560.110 of this part, the types of state laws preempted by paragraph (a) of this section include, without limitation, state laws purporting to impose requirements regarding: . . .

* * *

(6) Escrow accounts, impound accounts, and similar accounts[.]

(2)

No. 04-1553

Supreme Court, U.S.
FILED
JUL 27 2005
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

HANS W. FLAGG AND EILEEN S. FLAGG, on behalf of themselves and all others similarly situated,

Petitioners,

v.

YONKERS SAVINGS AND LOAN ASSOCIATION, FA, also known as Yonkers Financial,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION

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COUNTER-STATEMENT OF THE QUESTIONS PRESENTED

1. Are there compelling reasons for this Court to review the Second Circuit's decision upholding the District Court's dismissal of the complaint where the Second Circuit concluded that (a) lending and investment regulations of the federal Office of Thrift Supervision which preempt New York statutes that impose upon a federal savings association the obligation to pay interest on escrow funds for New York residential mortgages[1] are consistent with congressional intent, and (b) the federal Real Estate Settlement Procedures Act does not supersede the federal Home Owners Loan Act or prevent the Office of Thrift Supervision from asserting its regulatory authority over federal thrifts in connection with escrow accounts?

2. Are there compelling reasons for this Court to review the Second Circuit's decision upholding the District Court's decision that Respondent's exercise of its option not to pay interest on escrow funds, as permitted under the Office of Thrift Supervision regulations, was not a taking of Petitioners' property without just compensation, in violation of the Fifth Amendment to the United States Constitution?

---

1. The New York statutes at issue (the "New York Escrow Statutes") are: Section 5-601 of the New York General Obligations Law; Section 14b and Section 6-k(2)(b)b of the New York Banking Law; and Section 953(2) of the New York Real Property Tax Law.

TABLE OF CONTENTS

	Page
COUNTER-STATEMENT OF THE QUESTIONS PRESENTED	i
TABLE OF CONTENTS	ii
TABLE OF CITED AUTHORITIES	iv
COUNTER-STATEMENT OF THE CASE	1
COUNTER-STATEMENT OF PROVISIONS OF LAW INVOLVED	2
COUNTER-STATEMENT OF FACTS	3
REASONS FOR DENYING THE PETITION	5
Point I	
THE SECOND CIRCUIT CORRECTLY CONCLUDED THAT HOLA AND THE HOLA REGULATIONS PREEMPT THE NEW YORK ESCROW STATUTES	5
A. The HOLA Regulations Are Based Upon Reason And Within HOLA's Authority	5
B. Congress Did Not Intend RESPA Or HUD To Regulate A Federal Association's Obligation To Pay Interest On Escrows	14

Contents

Page

Point II

THE HOLA REGULATIONS DO NOT CONSTITUTE A CONSTITUTIONAL TAKING 21

A. A Federal Instrumentality Is Not A State Actor 22

B. The Bank's Compliance With Federal Regulations Does Not Render Its Conduct "Fairly Attributable" To The State 23

Point III

THIS CASE IS NOT APPROPRIATE FOR REVIEW BECAUSE IT POSES NO IMPORTANT FEDERAL AND CONSTITUTIONAL ISSUES 25

CONCLUSION 26

TABLE OF CITED AUTHORITIES

Page

Cases

American Mfrs. Mut. Ins. Co. v. Delores Scott Sullivan,
526 U.S. 40 (1999) 21, 23, 24

Andrews v. Federal Home Loan Bank of Atlanta,
998 F.2d 214 (4th Cir. 1993) 23, 24

Bank of America v. City and County of San Francisco,
309 F.3d 551 (9th Cir. 2002) 6, 20

Bank One v. Guttau,
190 F.3d 844 (8th Cir. 1999) 20

Blum v. Yaretsky,
457 U.S. 991 (1982) 25

Bloom v. Martin,
77 F.3d 318 (9th Cir. 1996) 16

Boulware v. Crossland Mortg. Corp.,
291 F.3d 261 (4th Cir. 2002) 16

Conference of Fed. Sav. and Loan Ass'ns v. Stein,
604 F.2d 1256 (9th Cir. 1979) 8

Ernst & Ernst v. Hochfelder,
425 U.S. 185 (1976) 16

Cited Authorities

Page

Federal Nat. Mortg. Ass'n v. Lefkowitz,
390 F. Supp. 1364 (S.D.N.Y. 1975) 11, 12

Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta,
458 U.S. 141 (1982) ..... *passim*

First Fed. Sav. & Loan Ass'n of Jackson County v. First Fed. Sav. & Loan Ass'n of Huntsville,
446 F. Supp. 210 (N.D. Ala. 1978) 22

First Fed. Sav. and Loan Ass'n of Lake Worth v. Brown,
707 F.2d 1217 (11th Cir. 1983) 10

Greenwald v. First Fed. Sav. Loan Ass'n of Boston,
446 F. Supp. 620 (D. Mass. 1978) 10

Haehl v. Washington Mut. Bank, F.A.,
277 F. Supp. 2d 933 (S.D. Ind. 2003) 10

International Paper Co. v. Ouellette,
479 U.S. 481 (1987) 20

Jamaica Sav. Bank v. Lefkowitz,
390 F. Supp. 1357 (E.D.N.Y.), *aff'd*, 423 U.S. 802 (1975) 11

Lugar v. Edmondson Oil Co., Inc.,
457 U.S. 922 (1982) 25

Cited Authorities

Page

Marquette Nat. Bank of Minneapolis v. First of Omaha Service Corp., 439 U.S. 299 (1978) 22

Medtronic, Inc. v. Lohr, 518 U.S. 470 (1996), *cert. denied*, 538 U.S. 1069 (2003) 7, 12

MorEquity, Inc. v. Naeem, 118 F. Supp. 2d 885 (N.D.Ill. 2000) 14

Pedraza v. United Guar. Corp., 114 F. Supp. 2d 1347 (S.D. Ga. 2000) 16

San Francisco Arts & Athletics, Inc. v. United States Olympic Committee, 483 U.S. 522 (1987) 22, 25

Thomas v. Ocwen Federal Bank FSB, 2002 WL 99737 (N.D. Ill. 2002) 16-17

Udall v. Tallman, 380 U.S. 1 (1965) 12

United States v. Locke, 529 U.S. 89 (2000) 6, 20

Wisconsin League of Financial Institutions, Ltd. v. Galecki, 707 F. Supp. 401 (W.D.Wis. 1989) 10, 13

Cited Authorities

Page

Statutes

12 U.S.C. § 1462a(b)(2) 2, 7

12 U.S.C. § 1463(a)(2) 2

12 U.S.C. § 1464(a) 1, 2

12 U.S.C. § 2601(b)(3) 19

12 U.S.C. § 2601 14

12 U.S.C. § 2601(a), (b) (2001) 15

12 U.S.C. § 2616 ..... 2, 13, 19

Regulations

12 C.F.R. § 545.2 ..... 2, 8

12 C.F.R. § 545.93(a) 9

12 C.F.R. Part 560 1

12 C.F.R. § 560.2(a) 2, 8

12 C.F.R. § 560.2(b)(6) 10

24 C.R.R. § 3500.17 17

COUNTER-STATEMENT OF THE CASE

Federal regulations preempt any state law that would require a federal savings association to pay interest on escrow funds in the absence of the written agreement of the parties to the mortgage that the lender will pay interest. Section 5(a) of the Home Owners Loan Act, 12 U.S.C. § 1464(a) ("HOLA"), as implemented by the Office of Thrift Supervision ("OTS") Lending and Investment Regulations, 12 C.F.R. Part 560 (the "HOLA Regulations").

The HOLA Regulations further Congress' intent to give the OTS plenary authority to regulate all aspects of the lending operations of federal thrifts, thus ensuring a single set of uniform federal laws and regulations applicable to the thrifts' operations nationwide. The federal regulatory framework, which relieves federal thrifts of the obligation to pay interest on escrow accounts while preserving the customer's right to negotiate for a different arrangement with the federal thrift, has a rational basis and is within the scope of the OTS' statutory authority.

Petitioners' contrary contention, that the Real Estate Settlement Procedures Act ("RESPA") governs a lender's obligation to pay interest on escrow accounts is, simply put, wrong. Petitioners wrongly assume the purpose of RESPA is to govern all aspects of escrow accounts. They then posit erroneously that RESPA is intended to govern a federal thrift's obligation to pay escrow interest. From this weak set of premises, they argue that the HOLA Regulations are inconsistent with RESPA and must give way. Even the Department of Housing and Urban Development ("HUD"), the agency appointed by Congress to implement RESPA, has stated unequivocally that RESPA does not grant it authority to regulate interest on escrows. Because Petitioners' thesis is wrong, their conclusion is wrong.

Petitioners similarly have no basis for their claim that, because Petitioners did not seek or obtain the voluntary agreement for the payment of interest which federal law contemplates, Respondent, a private corporation, engaged in a "taking" of their property without just compensation under the Fifth Amendment to the United States Constitution. Any viable "taking" claim requires conduct by a state actor. Yonkers Savings and Loan Association, F.A. (the "Bank")[2], a federally-chartered savings and loan association, is not a state actor.

COUNTER-STATEMENT OF PROVISIONS OF LAW INVOLVED

Contrary to Petitioners' characterization of Congress' intent with respect to preemption of state laws, RESPA does not govern all aspects of escrow accounts. In particular, RESPA and its savings provision, 12 U.S.C. § 2616, do not evince an intent to block preemption of state escrow laws pertaining to interest on escrow accounts.

In addition to the OTS Regulations identified by Petitioner – 12 C.F.R. §§ 545.2 and 560.2 – the statutory authority for the OTS Regulations demonstrates Congress' intent to give the OTS plenary authority to regulate the lending operations of federal thrifts. *See* 12 U.S.C. § 1462a(b)(2) ("The Director may prescribe such regulations and issue such orders as the Director may determine to be necessary for carrying out this chapter and all other laws within the Director's jurisdiction"); § 1463(a)(2) ("The Director may issue such regulations as the Director determines to be appropriate to carry out the responsibilities of the Director or the Office"); § 1464(a) (the OTS is authorized "under such regulations as the Director may prescribe to provide for the organization, incorporation, examination, operation and

2. Atlantic Bank of New York is the successor by merger to the Bank.

regulation of associations to be known as Federal savings associations").

COUNTER-STATEMENT OF FACTS

The factual background recited by Petitioners was either admitted by Respondent for purposes of Petitioners' summary judgment motion only, or was alleged in Petitioners' Complaint and deemed admitted for purposes of Respondent's motion to dismiss the Complaint.

Although Petitioners correctly assert that they commenced a class action on behalf of themselves and other similarly situated borrowers, the District Court declined to address Petitioners' Rule 23 class certification claims in light of its decision granting Respondent's motion to dismiss the Complaint in its entirety and without leave to replead.

The Second Circuit affirmed the judgment of the District Court, which granted Respondent's motion to dismiss the Complaint without leave to replead, denied Petitioners' motion for summary judgment as moot, and declined to decide Petitioners' motion for class certification. The Second Circuit found no merit in the issues that Petitioners raised on appeal, namely, that New York law requires that the Bank pay them interest on their mortgage escrow account and that the District Court erred in dismissing their Fifth Amendment claim.

The Second Circuit rejected Petitioners' contention that the OTS' preemption of state law pertaining to escrow interest exceeds the authority granted the OTS by HOLA and is an arbitrary and unreasonable exercise of its regulatory power. The Court began its analysis by noting that regulations intended to preempt state law are subject to judicial review only to determine whether the agency administrator has exceeded his statutory authority or acted arbitrarily. The Court noted that there

was no presumption against federal preemption in the regulation of federally chartered banks, because that area had been substantially occupied by federal authority for a long time. Further, the Court examined the statutory authority of the OTS Director to issue regulations, finding it "an extremely broad grant of power that provides ample authority" for the OTS to enforce consistent, nationwide regulations affecting lending practices by preempting state laws purporting to impose requirements concerning escrow accounts.

Though noting that the particular OTS regulation at issue here had not previously come before it, the Second Circuit found ample analogues and precedent to demonstrate that this exercise of preemption was within reason and within HOLA's grant of authority, including this Court's decision in *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982). OTS Regulations, the Court emphasized, expressly contemplate that the individual parties may provide for the payment of interest by negotiating for that provision. The Court concluded that this provided a level of flexibility that defeated any accusation of arbitrariness.

The Court rejected Petitioners' claim that the OTS regulation was unreasonable and unauthorized as inconsistent with RESPA. First, the Court held that RESPA and HOLA are not coextensive, because "RESPA regulates a narrow field of financial transactions engaged in by a broad group of financial institutions" while "HOLA regulates a specific breed of financial institutions in respect of all of their transactions and activities. . . . Given that HOLA deals with institutions and RESPA deals with transactions," the Court held that it made no sense to read RESPA as superseding HOLA and preventing the OTS from regulating a federal thrift's obligation to escrow interest. Second, the Court rejected Petitioners' interpretation of the purpose of RESPA as designed to reduce the expenses

incurred by a borrower. The Court held that RESPA is meant to regulate the amount of money a borrower is required to deposit in escrow by tying it to the costs the escrow fund is meant to secure. However, RESPA is not designed as a revenue producer, in the form of escrow interest, even if the net result is to reduce the expense to the borrower.

Finally, the Court rejected Petitioners' contention that, by availing itself of the option afforded by federal regulation to not pay escrow interest, the Bank was automatically transformed into a state actor for purposes of a Fifth Amendment taking claim.

REASONS FOR DENYING THE PETITION

I. The Second Circuit Correctly Concluded That HOLA And The HOLA Regulations Preempt The New York Escrow Statutes

This Court's Rules provide that a petition for a writ of certiorari will be granted only for "compelling reasons," and in certain limited circumstances, Sup. Ct. R. 10 (a) – (c). This case presents none of these circumstances, nor any compelling reasons for the review sought. The Second Circuit's decision is consistent with relevant decisions of other United States courts of appeal and with this Court's own decisions. Petitioners' application should therefore be denied.

A. The HOLA Regulations Are Based Upon Reason And Within HOLA's Authority

Petitioners attack the Second Circuit's preemption decision on two bases. First, they argue that Congress intended RESPA — not HOLA — to govern a federal savings association's obligation to pay interest on escrow accounts. Second, Petitioners contend the OTS acted arbitrarily when it enacted

the HOLA Regulations. Each claim, however, is directly contrary to all indications of congressional intent, and neither can be squared with this Court's declaration confirming the wide-ranging mandate of HOLA and the plenary authority of the OTS. Both claims also are undermined by HUD's pronouncement that it *does not* have authority under RESPA to regulate a lender's obligation to pay interest on escrows.

The Second Circuit undertook a straightforward assessment of Congress' intent with respect to both Acts. It correctly concluded that the HOLA Regulations are based upon reason and are within HOLA's grant of authority. The Second Circuit also correctly concluded that RESPA and HOLA are not coextensive; rather, RESPA "regulates a narrow field of financial transactions engaged in by a broad group of financial institutions" while HOLA "regulates a specific breed of financial institutions in respect of all their transactions and activities." Appendix A – Opinion of the United States Court of Appeals for the Second Circuit Decided January 21, 2005 ("Opinion") at 10a.

As the Second Circuit noted, federal regulations have the same preemptive effect as federal statutes as long as the administrator has not exceeded his statutory authority or acted arbitrarily. Opinion at 5a. As a result, the Second Circuit addressed directly whether the OTS regulation preempting state laws concerning escrow accounts was either in excess of statutory authority or arbitrary.

First, the Second Circuit reasoned, there is no presumption against federal preemption "when the State regulates in an area where there has been a history of significant federal presence." *United States v. Locke*, 529 U.S. 89, 108 (2000). The field of banking is one such area. *Bank of America v. City and County of San Francisco*, 309 F.3d 551, 558 (9th Cir. 2002). Through

HOLA, Congress established a "significant federal presence," regulating all aspects of the operation of federal savings associations. *de la Cuesta*, 458 U.S. at 144. As this Court declared,

> Congress delegated to the [Federal Home Loan Bank Board ("FHLBB"), now the OTS] broad authority to establish and regulate 'a uniform system of [savings and loan] institutions where there are not any now,' and to 'establish them with the force of the government behind them, with a national charter.' . . . And the [OTS] has exercised that discretion, regulating comprehensively the operations of these associations, including their lending practices and, specifically, the terms of loan instruments.

Id. at 166 (citation omitted).[3] Next, the Second Circuit looked at Congressional intent. *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485-486 (1996), *cert. denied*, 538 U.S. 1069 (2003). The Second Circuit noted the "extremely broad grant of power" afforded by HOLA, specifically citing its statutory provisions that "[t]he Director [of the OTS] may issue such regulations as the Director determines to be appropriate to carry out the responsibilities of the Director or the Office," and that "the Director is authorized, under such regulations as the Director may prescribe, to provide for the . . . operation and regulation of associations to be known as Federal savings associations." Opinion at 6a-7a. This language establishes the OTS' extensive authority to regulate all aspects of federal thrifts' lending operations.[4]

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3. The OTS is the successor to the FHLBB. Except as otherwise noted, the FHLBB will be referred to as the "OTS."

4. *See also* 12 U.S.C. § 1462a(b)(2) ("The Director may prescribe such regulations and issue such orders as the Director may determine to be necessary for carrying out this chapter and all other laws within the Director's jurisdiction.")

More than twenty years ago, this Court confirmed that Congress intended the OTS to have plenary and exclusive authority to regulate, monitor and examine federal savings associations from cradle to grave. *de la Cuesta*, 458 U.S. at 160 ("The broad language of §5(a) expresses no limits on the [OTS'] authority to regulate the lending practices of federal savings and loans."); *see Conference of Fed. Sav. and Loan Ass'ns v. Stein*, 604 F.2d 1256, 1260 (9th Cir. 1979) ("In our judgment the regulatory control of the [OTS] over federal savings and loan associations is so pervasive as to leave no room for state regulatory control"), *aff'd*, 445 U.S. 921 (1980). As this Court observed, "'it would have been difficult for Congress to give the [OTS] a broader mandate.'" *de la Cuesta*, 458 U.S. at 161 (citations omitted). In enacting HOLA, Congress intended to rectify the inadequacies of the existing state systems and, in doing so, Congress clearly envisioned that "federal savings [associations] would be governed by what the [OTS] — not any particular State — deemed to be the 'best practices.'" *Id.* (citation omitted).

In keeping with this Congressional mandate, the HOLA Regulations explicitly restate the OTS' intent to occupy the entire field of lending regulation for federal thrifts: "OTS hereby occupies *the entire field of lending* regulation for federal savings associations." 12 C.F.R. § 560.2(a) (emphasis added). Consistent with congressional intent, "[t]his exercise of the [OTS'] authority is preemptive of *any* state law purporting to address the subject of the operations of a Federal savings association." 12 C.F.R. §545.2 (1996) (emphasis added). "Congress expressly contemplated, and approved, the Board's promulgation of regulations superseding state law." *de la Cuesta*, 458 U.S. at 162.

The rationale for the exercise of this plenary authority is explicit and reasoned, as the Preamble to the HOLA Regulations explains.

> [I]nstead of being subject to a hodgepodge of conflicting and overlapping state lending requirements, federal thrifts [shall be] free to originate loans under a single set of uniform federal laws and regulations. This furthers both the "best practices" and safety and soundness objectives of the HOLA by enabling federal thrifts to deliver low-cost credit to the public free from undue regulatory duplication and burden. At the same time, the interests of borrowers are protected by the elaborate network of federal borrower-protection statutes applicable to federal thrifts. . . .

61 Fed. Reg. 50951-01, 50965 (Sept. 30, 1996).

The HOLA Regulations have a rational basis because they directly serve the purpose of HOLA. Pursuant to HOLA, the Federal Home Loan Bank Board created a national system of savings and loan associations to deliver low-cost credit to the public free of undue regulatory duplication and burden. 61 Fed. Reg. at 50965 (Preamble to HOLA Regulations). Because a federal association has the ability to "branch" anywhere throughout the United States and its territories, 12 C.F.R. § 545.93(a), and lending lies at the heart of the business of a federal association, 61 Fed. Reg. at 50965, subjecting federal associations to the "hodgepodge of conflicting and overlapping state lending requirements," *id.*, would harm the efficient operation of a federal association.

The Second Circuit also specifically held that the broad powers conferred upon the OTS to regulate the operation of

savings and loans gave it ample authority to promulgate and enforce regulations concerning escrow accounts. That determination is similarly correct. Congress' explicit delegation to OTS of jurisdiction over the "operation" of savings and loans "must empower the [OTS] to issue regulations governing mortgage loan instruments, for mortgages are a central part of any savings and loan's 'operation.'" *de la Cuesta*, 458 U.S. at 161.[5] That function necessarily encompasses mortgage escrow accounts. *See Wisconsin League of Financial Institutions, Ltd. v. Galecki*, 707 F. Supp. 401, 405 (W.D. Wis. 1989) (there can be "no dispute" that the "phrase [operations of a federal Association] extends at least to the regulation of mortgage escrow accounts"); *Greenwald v. First Fed. Sav. Loan Ass'n of Boston*, 446 F. Supp. 620, 624 (D. Mass. 1978) (HOLA Regulations preempt state laws requiring payment of interest on mortgage escrow funds held to pay real estate taxes), *aff'd*, 591 F.2d 417 (1st Cir. 1979).

The OTS has therefore explicitly provided, 12 C.F.R. § 560.2(b)(6), that:

> the types of state laws preempted by paragraph (a) of this section include, without limitation, state laws purporting to impose requirements regarding:
>
> * * *
>
> (6) Escrow accounts, impound accounts and similar accounts; . . . .

5. *See, e.g., First Fed. Sav. and Loan Ass'n of Lake Worth v. Brown*, 707 F. 2d 1217, 1221 (11th Cir. 1983) (Board's regulations governing due-on-sale provisions preempts state law limitations on the due-on-sale practices of federal savings and loan associations); *Haehl v. Washington Mut. Bank, F.A.*, 277 F. Supp. 2d 933, 942 (S.D. Ind. 2003) (HOLA Regulations preempt state law allowing banks and savings associations to pass on to customers only bona fide reconveyance fees).

While the Second Circuit noted that this specific regulation pertaining to escrow accounts had not previously been adjudicated in the Second Circuit, the Court found ample analogous precedent demonstrating that the regulation was within reason and within HOLA's grant of authority. The Court likened the escrow regulation to, among others, HOLA's regulation concerning the inclusion of "due-on-sale clauses" that this Court considered and upheld in *de la Cuesta*. Moreover, the Second Circuit found significant that the HOLA Regulations afford the parties the opportunity to contract out of the preemptive effect of the Regulations, and negotiate for the payment of escrow interest. This ability to contract out of the federal regulatory framework "provides a consistent nationwide playing field while giving individual institutions a level of flexibility. This achievement alone demonstrates that preemption in this field is sensible enough to dodge accusations of arbitrariness in the abstract." Opinion at 8a.[6]

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6. The only cases Petitioners cite specifically addressing the New York Escrow Laws are inapposite. *Jamaica Sav. Bank v. Lefkowitz*, 390 F. Supp. 1357 (E.D.N.Y.), *aff'd*, 423 U.S. 802 (1975), concerned the constitutionality of a New York escrow statute as applied to a state-chartered bank, a fact that Petitioners concede. By contrast, the case before this Court concerns HOLA's preemption of such a statute insofar as it purports to govern *federally-chartered* institutions. *Federal Nat. Mortg. Ass'n v. Lefkowitz*, 390 F. Supp. 1364 (S.D.N.Y. 1975), also cited by Petitioners, concerned the Federal National Mortgage Association ("FNMA") — not a federal savings association. Further, the court was persuaded that FNMA should comply with New York escrow statutes because

> Congress has not indicated whether FNMA should be exempt from the type of state regulation established by [the statutes]. In the absence of such a specific authorization, we find that the payment of interest on the

(Cont'd)

Because the HOLA Regulations are consistent with congressional intent, the OTS' interpretation of those regulations is entitled to substantial deference. *Medtronic*, 518 U.S. at 496; *Udall v. Tallman*, 380 U.S. 1, 16 (1965) (interpretation of a statute by the officers or agency charged with its administration is entitled to "great deference"). The OTS has explicitly found that state escrow laws in general, and the New York Escrow Laws in particular, are preempted, consistently reaffirming that result in its opinion letters addressing that issue. OTS Op. Chief Counsel dated October 6, 2003 (specifically stating that the New York Escrow Statutes at issue in this case are preempted) (A-180)[7]; Opinion of the General Counsel of the Federal Home Loan Bank Board ("FHLBB Op. General Counsel") dated August 13, 1985 (addressing the scope of federal preemption in light of New York law requiring the payment of interest on escrow accounts, and stating the New York laws are preempted) (A-83); OTS Op. Chief Counsel dated January 3, 1991 (stating that section 953 of the New York Real Property Tax Law – relied upon here by Petitioners – is preempted by the HOLA Regulations) (A-86).[8]

(Cont'd)

> escrow accounts does not impose such a burden on the performance of FNMA's function as to invalidate the statute.

390 F. Supp. at 1368. Here, pursuant to its congressional mandate, the OTS has stated in no uncertain terms that the HOLA Regulations do preempt state escrow statutes, thus exempting federal associations from their reach.

7. References to the Joint Appendix on Appeal to the Second Circuit Court of Appeals are designated herein as "A-__".

8. *See also* FHLBB Op. General Counsel dated September 24, 1984 (Maine state laws purporting to impose obligations on federal associations to pay interest on escrow accounts "other than those

(Cont'd)

Petitioners contend that the Second Circuit erred because the issue is whether preemption by the HOLA Regulations is consistent with Congressional intent under RESPA, and that the Second Circuit's analysis turned "on its head" the "primacy of Congress' intent . . ." Petition for a Writ of Certiorari ("Petition") at 16. Rather, it is Petitioners' argument that turns the law "on its head." The issue is whether preemption by the HOLA Regulations is consistent with congressional intent under *HOLA* – not under RESPA. Petitioners' contrary premise is the fundamental error that informs their entire analysis.

Petitioners contend that HOLA does not govern escrow accounts because no provision in the Act specifically mentions that area. Citing certain provisions of RESPA that address discrete aspects of escrow accounts, Petitioners advocate that RESPA governs every aspect of a federal thrift's operation of an escrow account. Having postulated such widespread application of RESPA, Petitioners contend RESPA's so-called "savings clause," 12 U.S.C. § 2616, blocks the preemptive effect of HOLA's federal regulations. The hidden assumptions contained in this analysis fatally undermine its conclusion.

The plenary authority that Congress explicitly conveyed to the OTS in HOLA, and that this Court recognized in *de la Cuesta*, makes explicit reference to specific subject areas unnecessary. This Court recognized that Congress gave the OTS

(Cont'd)

provided for in their loan contracts" are preempted by the HOLA Regulations) (A-92); OTS Op. Chief counsel dated November 17, 1998 (reiterating that "state laws that require lenders to pay interest on escrow accounts for hazard insurance and real estate taxes are preempted by federal law for federal savings associations") (A-94). *Accord: Wisconsin League*, 707 F. Supp. at 405 (W.D. Wis. 1989) (state statutes purporting to impose a requirement on a lender to pay interest on escrow funds were preempted by the HOLA Regulations).

the broadest possible mandate to regulate the operation of federal thrifts, and escrow accounts are included within that operation. Contrary to Petitioners' claim that escrow accounts are the "raison d'etre" for RESPA, Petition at 21, it was never the intent and purpose of RESPA to regulate federal thrifts in connection with the payment of escrow interest.

B. Congress Did Not Intend RESPA Or HUD To Regulate A Federal Association's Obligation To Pay Interest On Escrows

Despite the clear mandate given by Congress to the OTS, Petitioners contend that Congress intended under RESPA to give the Secretary of HUD exclusive authority to regulate a federal thrift's operation of a mortgage escrow account. That is a faulty premise. The language and purpose of RESPA evince that Congress did not intend RESPA or HUD to govern any lender's obligation to pay interest on escrows — a conclusion that HUD itself has confirmed in no uncertain terms.

Petitioners reach their conclusion only by ignoring the explicit language of RESPA itself, which reflects that Congress intended RESPA to govern only two issues related to escrow accounts — how the amount a borrower must deposit is calculated, and what disclosures a lender must provide. Congress enacted RESPA to provide consumers with appropriate disclosure concerning the nature and costs of the settlement process and to limit the amounts borrowers are required to pay into their escrow accounts. 12 U.S.C. § 2601 (2002). *See MorEquity, Inc. v. Naeem*, 118 F. Supp. 2d 885, 900 (N.D. Ill. 2000) (RESPA's "principal purpose is to protect home buyers from material non-disclosures in settlement statements and abusive practices in the settlement process."). Nowhere does RESPA address or in any way govern a lender's obligation to pay interest on escrow accounts. Section 2601 of RESPA,

entitled "Congressional findings and purpose," states specifically that:

> (a) The Congress finds that significant reforms in the *real estate settlement process* are needed to insure that consumers throughout the Nation *are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges* caused by certain abusive practices that have developed in some areas of the country. . . .
>
> (b) It is the purpose of this chapter *to effect certain changes in the settlement process* for residential real estate that will result —
>
> (1) *in more effective advance disclosure to home buyers and sellers of settlement costs*;
>
> (2) *in the elimination of kickbacks or referral fees* that tend to increase unnecessarily the costs of certain settlement services;
>
> (3) *in a reduction in the amounts home buyers are required to place in escrow accounts* established to insure the payment of real estate taxes and insurance; and
>
> (4) in significant reform and modernization of local recordkeeping of land title information.

12 U.S.C. § 2601(a), (b) (2001) (emphasis added).

There is no mention in any of the HUD regulations — or, indeed, anywhere in RESPA itself — of any authority to regulate escrow interest. Nonetheless, Petitioners contend that, because the HUD regulations cover certain aspects of escrow accounts, Congress intended RESPA to cover *all* aspects of escrow accounts, including a lender's obligation to pay interest on escrows. This simplistic theory proves false on analysis.

The language of RESPA itself and HUD's regulations speak very precisely to a lender's obligation to make particular types of disclosures and to implement carefully delineated accounting procedures. When a statute speaks in such specific terms, courts are not empowered to expand its scope. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 201-02 (1976). RESPA's statutory scheme is not an open invitation to agency regulation of every aspect of an escrow account. *Id.* at 213-14.

Petitioners' position, if accepted, would impermissibly expand RESPA's substantive coverage beyond the statute's purpose — disclosure and accounting regulations. RESPA's legislative history "counsels *against* liberal interpretation of its remedial provisions. . . ." *Pedraza v. United Guar. Corp.*, 114 F. Supp. 2d 1347, 1354 n.13 (S.D. Ga. 2000) (emphasis added). *See also Boulware v. Crossland Mortg. Corp.*, 291 F. 3d 261, 267-68 (4th Cir. 2002) (RESPA is meant to address certain practices, not to enact broad controls, and therefore prohibition on kickbacks does not cover overcharges for credit reports); *see also Bloom v. Martin*, 77 F.3d 318, 321 (9th Cir. 1996) (RESPA does not require disclosure of reconveyance and demand fees due when a mortgagor sells his house because "RESPA's non-exhaustive list of settlement services . . . suggests a limitation to costs payable at or before settlement."); *Thomas v. Ocwen Federal Bank FSB*, 2002 WL 99737, *4 (N.D. Ill.

2002) (claims under RESPA typically accrue on the date of the closing of the loan; "fee-splitting" prohibition of RESPA does not apply to charges incurred after closing).

Notably, HUD has announced that its regulations **do not** govern interest on escrow accounts and that HUD **does not** have the statutory authority to regulate that area. During the public comment process of promulgating 24 C.F.R. § 3500.17 (Regulation X), HUD published its analysis and responses to public comments on its proposed rules explaining the history of the rule, its purpose, and the rationale underlying the final formulation of each of its provisions. In a section entitled "Interest on Escrow Accounts and Single-Item Escrow Accounts," HUD refuted the very position Petitioners espouse by stating in response to public comments that it has no authority under RESPA to regulate interest on escrow accounts. HUD stated:

> Commenters asked whether the final rule would address interest on escrow accounts. Seven commenters suggested that the rule specifically exempt servicers that either pay interest on escrow accounts or service only one escrow item. These commenters believed that a required interest payment on escrow account balances would create a disincentive to servicers to over-escrow.
>
> After considering the comments, the Department determines that it will not create the requested exemptions. *The Department does not interpret Section 10 of RESPA as providing the Department with legal authority to require payment of interest on escrow accounts. Where interest is required, it is*

> *a matter of State law, with fourteen States requiring that some amount of interest be paid on escrow account funds.*

59 Fed. Reg. at 53891 (emphasis added).[9]

In the face of HUD's clear expression of the limitations of its own authority, Petitioners' contention that HUD is the sole agency authorized to regulate interest on escrow accounts is simply baffling.

Petitioners contend that RESPA should be read to govern the payment of escrow interest because paying interest would have the practical effect of reducing the amount that borrowers are required to place in escrow accounts. The Second Circuit correctly rejected this argument, holding that

> RESPA is meant to regulate the amount of money that a borrower is required to deposit in escrow by tying that amount to the costs the escrow fund is meant to secure. RESPA is not, however, designed to reduce the dollar costs of taxes, fees, and insurance premiums. RESPA can, and does, accomplish its task by setting rules on required escrow contributions. That this system may, in the end, be more expensive to borrowers than, say, keeping their money in interest-bearing accounts to pay their own bills, does not violate RESPA's stated goal of "reduce[ing] the

9. Section 3500.17 was reissued, *see* 61 Fed. Reg. 1233 (Jan. 18, 1996), and then amended on several occasions. *See* 61 Fed. Reg. 46510 (Sept. 3, 1996); 61 Fed . Reg. 50219 (Sept. 24, 1996); 61 Fed. Reg. 58476 (Nov. 15, 1996); 63 Fed. Reg. 3236 (Jan. 21, 1998); 68 Fed. Reg. 12789 (March 17, 2003). Neither the revisions nor the accompanying HUD commentary included any further discussion of escrow interest.

> amounts home buyers are required to place in escrow accounts." 12 U.S.C. § 2601(b)(3).

Simply put, the purpose of RESPA is to protect borrowers against being required to deposit significantly more in an escrow account than is needed to pay requisite fees and expenses. Congress did not direct that purpose be accomplished by requiring the escrow account to generate income for the borrower, even if the practical effect would be to reduce the borrower's out-of-pocket costs.

Because Petitioners' premise that RESPA governs, or empowers HUD to regulate, escrow interest is incorrect, Petitioners' conclusion that RESPA supersedes HOLA is incorrect. The Second Circuit decisively rejected this contention, holding that RESPA and HOLA are not coextensive. In succinctly juxtaposed descriptions, the Second Circuit held that

> [b]y design . . . RESPA regulates a narrow field of financial transactions engaged in by a broad group of financial institutions . . . while HOLA regulates a specific breed of financial institutions in respect of all their transactions and activities. . . . Given that HOLA deals with institutions and RESPA deals with transactions, it simply does not make sense to read RESPA as superceding HOLA and preventing the OTS from asserting regulatory authority over the policies and practices of federal savings associations with respect to escrow accounts.

Opinion at 10a.

Because the statutes are not coextensive, the Second Circuit also correctly rejected Petitioners' contention that RESPA's so-called "savings clause", 12 U.S.C. § 2616, bars preemption. Indeed, this Court and others have routinely held that virtually

identical anti-preemption clauses in various federal statutes apply only to the preemptive effect of the statute in which the clause is contained.[10] That conclusion can only be correct. If §10 of RESPA does not regulate or authorize HUD to regulate interest on escrows, it follows that RESPA's "savings clause" cannot reasonably be read to interfere with the OTS' regulatory authority over this matter for federal associations.

Notably, when the OTS conducted a comprehensive review of its regulations in 1996, it reaffirmed the preemptive effect of the HOLA Regulations and also considered the interplay of those Regulations with other federal statutes, like RESPA, that "disclaim any intent to preempt non-conflicting state statutes falling in the same subject area." 61 Fed. Reg. at 50966. The OTS drew a significant distinction between RESPA, which governs all types of lenders, including state-chartered institutions, and HOLA, which governs federal savings associations. It made sense, the OTS noted, that RESPA would not preempt state laws because state-chartered banks must comply with state law and RESPA. According to the OTS, that does not, however, affect in any way the preemptive effect of the HOLA Regulations that govern federal associations, which

10. *See, e.g., United States v. Locke*, 529 U.S. 89, 106 (2000) (anti-preemption clause in Oil Pollution Act did not "extend to subjects addressed in the other titles of the Act or other acts" and therefore did not preclude preemption of state laws by Ports and Waterways Safety Act); *International Paper Co. v. Ouellette*, 479 U.S. 481, 493-94 (1987) (anti-preemption clause in citizen-suit provisions of the Clean Water Act did not "preclude preemption of state law by other provisions of the Act"); *Bank of America*, 309 F.3d at 565-66 (anti-preemption clause in Electronic Funds Transfer Act is limited to that Act and "does not save the Ordinances against preemption by the HOLA and the National Bank Act."); *Bank One v. Guttau*, 190 F. 3d 844, 850 (8th Cir. 1999) (anti-preemption provision in Iowa Electronic Funds Transfer Act does not save state regulations from preemption by National Bank Act).

are uniquely federalized institutions. In that regard, the OTS observed that the First Circuit's holding in *Greenwald*, that the HOLA Regulations preempt state laws on escrow interest,

> reflects a correct understanding of the interplay between the HOLA and the above-referenced statutes [including RESPA], as evidenced by the legislative history of the HOLA.

61 Fed. Reg. at 50966.

The Second Circuit therefore correctly rejected Petitioners' challenge to the HOLA Regulations as inconsistent with, and superseded by, RESPA.

II. The HOLA Regulations Do Not Constitute A Constitutional Taking

Petitioners claim that the Bank's conduct in not paying interest (as allowed by the HOLA Regulations) constituted a taking of Petitioners' property, in violation of the Fifth Amendment of the United States Constitution, for which they were entitled to just compensation.

As Petitioners recognize, in order to state a viable Fifth Amendment claim, they must first establish that the conduct complained of constitutes "state action." *See, e.g., American Mfrs. Mut. Ins. Co. v. Delores Scott Sullivan*, 526 U.S. 40 (1999).

Petitioners offer two theories to transform the Bank into a state actor. First, they claim that the Bank is a "federal instrumentality," which they equate, without any authority, with state action for purposes of the Fifth Amendment. Second, they claim without any support that a choice afforded by federal law is the same thing as a requirement of federal law, thereby satisfying the state action requirement. Both claims are contrary to long-established legal authority.

A. A Federal Instrumentality Is Not A State Actor

Petitioners contend that the Bank is a "federal instrumentality" and suggest that this alone demonstrates that it is a state actor. However, "[a] finding of state action may not be premised solely on the private entity's creation, funding, licensing, or regulation by the government." *San Francisco Arts & Athletics, Inc. v. United States Olympic Committee*, 483 U.S. 522, 543-44 (1987). There is no authority that a federal instrumentality is a state actor for Fifth Amendment purposes. Petitioners' reliance on only two cases, both of which are entirely inapposite, proves this to be so.

Petitioners rely principally upon *First Fed. Sav. & Loan Ass'n of Jackson County v. First Fed. Sav. & Loan Ass'n of Huntsville*, 446 F. Supp. 210 (N.D. Ala. 1978). There, one federal association sued another, asserting claims for unfair competition under state and common law. There were no Fifth Amendment claims whatsoever. The court merely noted in denying a motion to remand that "[f]ederal associations are instrumentalities and agencies of the United States," and concluded that the claims of unfair competition were governed by federal law.

Similarly, *Marquette Nat. Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978), had nothing whatever to do with a Fifth Amendment claim. Rather, this Court considered whether a national bank located in Nebraska could charge its Minnesota credit card customers the higher interest rate sanctioned by Nebraska law. In ruling that it could, this Court held that a national bank is an "'instrumentalit[y] of the federal government'" and, as such, governed by federal law. 439 U.S. at 308 (citation omitted).

Thus, nothing supports Petitioners' analysis that, even if a federal savings association were a "federal instrumentality," that status would transform the association into a state actor for purposes of the Fifth Amendment.

B. The Bank's Compliance With Federal Regulations Does Not Render Its Conduct "Fairly Attributable" To The State

Petitioners also contend that the OTS Regulations, which afford the Bank the option of not paying interest on escrows (and borrowers the choice of seeking credit elsewhere) is conduct that constituted "substantial 'encouragement' or 'involvement'" sufficient to automatically transform the Bank into a "state actor." Petition at 27. That conclusion is contrary to this Court's precedent.

In *American Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40 (1999), this Court rejected virtually the same argument, in considering the status of private insurers providing workers compensation coverage under state laws in the context of a Fourteenth Amendment and § 1983 claim. In that case, the private insurers acted in compliance with the Pennsylvania statutory workers compensation system by deferring payment for disputed medical treatment pending a review procedure set forth in the statute. The Court rejected an argument that the decision to withhold payment to providers was "fairly attributable" to the state because the state had "authorized" and "encouraged" that decision. Rather, the Court reasoned that the statute simply gave the private insurers the choice to withhold payment for disputed medical services. The Court noted that the State's decision to allow insurers to withhold payments pending review could be seen as "a legislative decision not to intervene in a dispute between an insurer and an employee over whether a particular treatment is reasonable and necessary" and held that "[s]uch permission of a private choice cannot support a finding of state action." 526 U.S. at 53-54.

In *Andrews v. Federal Home Loan Bank of Atlanta*, 998 F.2d 214 (4th Cir. 1993), the Fourth Circuit rejected the

contention that a regional federal home loan bank was a government actor. It therefore could not have violated the First Amendment when it discharged an employee pursuant to its statutory authority.[11] Noting that the bank was supervised and regulated by the Federal Home Loan Bank Board, which appointed certain of its directors and designated its chairman and vice-chairman, the Fourth Circuit nonetheless held that there was "ample reason to conclude that, despite its federal charter, the Bank operates more like a private entity than as a part of the federal government." 998 F. 2d at 216. The Fourth Circuit also rejected the notion that the defendant bank's conduct in terminating the employee was "fairly attributable" to the state, reasoning that it did not fall within any of four criteria: (1) the state did not coerce the bank to commit any act that would be unconstitutional if done by the state; (2) the state's delegation of the bank's supervisory responsibilities was not an evasion of a clear constitutional duty; (3) the state did not delegate a "traditionally and exclusively public function" to the bank, because the functions performed by the bank — banking and bank examination — "are not traditionally and exclusively public functions"; and (4) the bank did not enlist the state's aid merely by acting in furtherance of its statutory right to dismiss the employee.

Petitioners' conclusory assertion that an option is the same as a requirement for purposes of "state action" analysis has no basis. The Bank's and Petitioners' decisions to enter into a loan contract that provided for no interest was a "private choice [that] cannot support a finding of state action." *American Manufacturers*, 526 U.S. at 53-54. As expressly contemplated

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11. The Defendant was one of twelve regional banks set up by Congress under HOLA to provide services to member institution savings-and-loans, including allowing members to secure advances against their assets. 998 F.2d at 215

by the HOLA Regulations, the decision whether to contract to pay escrow interest was a voluntary one made by private parties. As such, no constitutional "taking" occurred, and the Second Circuit properly upheld the dismissal of the Complaint on this basis as well.

Petitioners' cases refute Petitioners' own conclusion. *See San Francisco Arts & Athletics*, 483 U.S. at 543-44 (1987) (United States Olympic Committee not a government agent merely because Congress granted it a corporate charter; finding of state action may not be premised solely on the private entity's creation, funding, licensing, or regulation by the government); *Lugar v. Edmondson Oil Co., Inc.*, 457 U.S. 922, 927 (1982) (state action only where there is "overt, official involvement in the property deprivation"); *Blum v. Yaretsky*, 457 U.S. 991, 1004 (1982) (fact that private business is subject to state regulation does not convert its action into State action; fact that State responds to decisions by private nursing homes to discharge or transfer Medicaid patients by adjusting Medicaid benefits does not make State responsible for such decisions). Petitioners cannot seek relief against the Bank for the alleged unconstitutionality of the HOLA Regulations.

III. This Case Is Not Appropriate For Review Because It Poses No Important Federal And Constitutional Issues

Petitioners have not demonstrated that the Second Circuit's decision conflicts with any relevant federal or state case law or, indeed, with this Court's own relevant decisions. Rather, Petitioners speculate outside of the record in urging this Court to consider the amount of interest that might be affected by a contrary ruling. Further, citing revisions that an unrelated agency (the Office of the Comptroller of the Currency) made to regulations governing unrelated institutions (national banks), Petitioners attempt to lend urgency to their application by

inviting this Court to conclude that federal administrative agencies are embarked on an unauthorized federalist trend to displace state laws pertaining to escrow accounts.

None of these entreaties is entitled to any weight. The issue here is whether there are compelling reasons for this Court to exercise its discretion to review the Second Circuit's decision. In this case, Petitioners' claim concerning preemption is based upon inferences that they urge this Court to draw by cobbling isolated references in RESPA. Petitioners' proposed inferences, however, are at odds with (i) the conclusion of the administrator of the responsible agency, HUD, that it lacks authority to regulate escrow interest; (ii) explicit declarations of congressional intent concerning both RESPA and HOLA; and (iii) this Court's decision recognizing the plenary authority of the OTS to regulate all aspects of the lending operations of federal thrifts. As a result, the inferences Petitioners would ask this Court to draw are impermissible.

CONCLUSION

Respondent respectfully requests that this Court deny Petitioners' Petition for a Writ of Certiorari.

Respectfully submitted,

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No. 04-1553

IN THE

Supreme Court of the United States

HANS W. FLAGG AND EILEEN S. FLAGG, on behalf of themselves and all others similarly situated,

Petitioners,

v.

YONKERS SAVINGS AND LOAN ASSOCIATION, FA, also known as Yonkers Financial,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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TABLE OF CONTENTS

	Page
TABLE OF CITED AUTHORITIES	ii
PRELIMINARY STATEMENT	1
I. Review Is Warranted Because The Second Circuit Opinion Substantially Departs From Or Fails To Consider This Court's Controlling And Other Pertinent Decisions	1
II. Review Is Warranted Because The Second Circuit Opinion Ignores And Misapplies This Court's State Action And Taking Decisions	8
III. Review Is Warranted Because Of The Importance Of This Case	10
CONCLUSION	10

TABLE OF CITED AUTHORITIES

Page

FEDERAL CASES:

Am. Mfrs. Mut. Ins. Co. v. Sullivan,
526 U.S. 40 (1999) 9

Andrews v. Fed. Home Loan Bank of Atlanta,
998 F.2d 214 (4th Cir. 1993) 9

Edmonson v. Leesville Concrete Co.,
500 U.S. 614 (1991) 9

Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta,
458 U.S. 141 (1982) 3, 8

First Fed. Sav. & Loan Ass'n of Boston v. Greenwald,
591 F.2d 417 (1st Cir. 1979) 3

Hawaii Hous. Auth. v. Midkiff,
467 U.S. 229 (1984) 10

Hines v. Davidowitz,
312 U.S. 52 (1941) 6

Int'l Paper Co. v. Ouellette,
479 U.S. 481 (1987) 8

Ray v. Atlantic Richfield Co.,
435 U.S. 151 (1978) 5

United States v. Locke,
529 U.S. 89 (2000) 5, 7, 8

Cited Authorities

Page

FEDERAL STATUTES, REGULATIONS AND RELATED MATERIALS:

12 C.F.R. § 545.2 8

12 C.F.R. § 560.2(a) 7

12 U.S.C. § 2601(b)(3) 6, 7

12 U.S.C. § 2609 7

12 U.S.C. § 2616 ..... 2, 3, 6, 7

59 Fed. Reg. 53,890 (Oct. 26, 1994) 3

H.R. Conf. Rep. No. 93-1526 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6569 ..... 3, 6

PRELIMINARY STATEMENT[1]

The OTS preemption regulations eliminating state law escrow interest obligations, and the Second Circuit holding that "Federal Law Preempts the Field of Mortgage Escrow Accounts Held by Federal Savings Associations" (Pet. App. A, 3a), *inter alia*, violate a fundamental precept of our federal system and the repeated holdings of this Court that when Congress so intends, respect must be accorded to the preserved regulatory power of the States.

The Fifth Amendment and the decisions of this Court, too, demand that respect be accorded by federal agencies to the property of mortgage borrowers living in the several States and territories with statutes entitling them to some amount of escrow interest.

This case squarely raises important issues regarding the Constitutional hierarchy among the branches of our federal government and between the federal government and the States that already have had, and will continue to have, an enormous collective impact on the many hundreds of thousands of affected mortgage borrowers (or more) residing throughout the United States and its territories. Petitioners respectfully submit that the Petition should be granted.

I. Review Is Warranted Because The Second Circuit Opinion Substantially Departs From Or Fails To Consider This Court's Controlling And Other Pertinent Decisions

Respondent's repeated assertion that the Petition is predicated on Congress' intent under RESPA that mortgage escrow interest be federally regulated (*e.g.*, Resp. Br. 1, 14) is a straw man, because no such intent exists or is alleged by Petitioners to exist. Rather, the Petition's RESPA-related claim

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1. References to Petitioners' Petition and the Petition's Appendix are denoted "Pet. __" and "Pet. App.__, __" respectively. References to Respondent's Brief in Opposition are denoted "Resp. Br. __." Capitalized terms used herein are defined as in the Petition.

is based on Congress' expressed intent in 12 U.S.C. § 2616 to *preserve* the separate States' regulatory power to provide additional consumer protection regarding mortgage escrow accounts - an intent determined to be applicable to escrow interest by the Secretary (the federal administrator Congressionally delegated to make such escrow-related preemption determinations for all federally- related mortgage loans).

What Respondent characterizes as "cobbling isolated references" to arrive at a "thesis" (Resp. Br. 26, 1) is simply the plain language and obvious import of the sources most relevant to the preemption issue here: the RESPA saving clause (12 U.S.C. § 2616), its legislative history, and its interpretation by the Secretary specifically in connection with escrow interest (Pet. 6-9). Respondent, like the Second Circuit, has avoided or conclusorily dismissed these materials. For the convenience of the Court, they are again excerpted here, beginning with the saving clause:

> This chapter does not annul, alter, or affect, or exempt any person subject to the provisions of this chapter from complying with, the laws of any State with respect to settlement practices, except to the extent that those laws are inconsistent with any provision of this chapter, and then only to the extent of the inconsistency. The Secretary is authorized to determine whether such inconsistencies exist. The Secretary may not determine that any State law is inconsistent with any provision of this chapter if the Secretary determines that such law gives greater protection to the consumer.

The contemporaneous legislative history plainly describes Congress' intent in enacting § 2616:

> *The House amendment permits States to enforce consumer protection requirements in connection with residential real estate transactions in addition to requirements of this Act.*

> The Senate bill has no similar provision. The conference report contains the House provision with an amendment which would conform this provision to the recently enacted amendments to the Truth-in-Lending Act (Public Law 93-495) defining the relationship of that law to State laws [as enacted in 12 U.S.C. § 2616].

H.R. Conf. Rep. No. 93-1526 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6569, 6572 (emphasis added).

The Secretary's interpretation of § 2616 is equally clear:

> *Regarding the possible preemption of State laws, the Department recognizes that many of the States have enacted laws relating to escrow accounts.* . . . Given th[e] statutory language [of § 2616], and further statutory instruction that *a state statute is not to be preempted if it gives greater protection to the consumer,* the Department believes it should make specific preemption decisions on a case-by-case basis.

59 Fed. Reg. 53890, 53900 (Oct. 26, 1994) (emphasis added).

> . . .The Department does not interpret Section 10 of RESPA as providing the Department with legal authority to require payment of interest on escrow accounts. *Where interest is required, it is a matter of State law, with fourteen States requiring that some amount of interest be paid on escrow account funds.*

59 Fed. Reg. at 53891 (emphasis added). *Cf. First Fed. Sav. & Loan Ass'n of Boston v. Greenwald,* 591 F.2d 417, 420 n.3 (1st Cir. 1979) (FHLBB regulations required payment of escrow interest *if required of state lending institutions under state law* until one year after *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta,* 458 U.S. 141 (1982) ("*de la Cuesta*")).

Respondent's answer to these sources is to argue that "[t]he issue is whether preemption by the HOLA Regulations is consistent with Congressional intent under HOLA - not under RESPA" (Resp. Br. 13). Petitioners, however, believe that the issue for this Court, fairly stated, is whether Congressional intent under HOLA *or* RESPA (or both) should be used to assess the validity of the HOLA preemption regulations as applied to state escrow interest laws.

Contrary to Respondent's (mis)characterization (Resp. Br. 13), Petitioners do *not* "contend that HOLA does not govern escrow accounts because no provision in the Act specifically mentions that area." Rather, Petitioners contend that the absence of any reference to "escrow accounts" in HOLA means that HOLA and its legislative history are not the best evidence of Congressional intent regarding the preemption of state escrow account laws (Pet. 9-10, 21). RESPA, by comparison, clearly evidences Congressional intent regarding escrow accounts and the preemption of state laws regarding escrow accounts. In such circumstances, resort to the rules of recency and specificity as aids to determining Congressional intent is proper (*see* Pet. 21).[2]

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2. According to the Second Circuit (Pet. App. A, 10a-11a):

> The more sensible reading of these statutes is that federal savings associations, like all grantors of mortgage loans, must abide by RESPA as interpreted by the Secretary of Housing and Urban Development. The OTS cannot, therefore, promulgate rules and regulations that are contrary to RESPA. That this is so does not, however, exclude the OTS from preempting the field of rules governing federal savings associations and establishing nationwide regulations governing these institutions that are consistent with federal law, including RESPA.

Simply stated, if the RESPA saving clause interpreted by the Secretary requires the payment of escrow interest and compliance with other state escrow laws for "federally related mortgage loans," then how can the OTS preemption regulations preempting *all* state escrow laws be "consistent with federal law, including RESPA"? Note 2 to the Second Circuit Opinion is self-referentially circuitous, and provides no answer at all (*see* Pet. 19, Pet. App. A, 11a at n.2).

Based on the Second Circuit's observation that HOLA and RESPA "are not coextensive" (Pet. App. A, 10a), Respondent argues that "this Court and others have routinely held that virtually identical anti-preemption clauses in various federal statutes apply only to the preemptive effect of the statute in which the clause is contained" (Resp. Br. 19-20). Respondent's suggestion that any of this Court's preemption decisions have been "routine" is an oversimplification, at best. The Court's analysis identified by Respondent as such a "routine holding" in *United States v. Locke*, 529 U.S. 89 (2000), illustrates why the fixed rule advocated by Respondent is nothing of the sort.

As in this case, *Locke* involved the preemptive reach on Washington State law of two related, but not coextensive, federal environmental maritime acts, the Ports and Waterways Safety Act of 1972 ("PWSA") and the Oil Pollution Act of 1990 ("OPA"). *Id.* at 101. The Ninth Circuit Court of Appeals ruled, in essence, that the saving clauses of the OPA confirmed an intention to return authority to the States regarding matters which this Court earlier held were preempted by the PWSA in *Ray v. Atlantic Richfield Co.*, 435 U.S. 151 (1978). *Id.* at 104. In rejecting the Ninth Circuit's broad construction of the OPA saving clauses, this Court stated:

> Placement of the saving clauses in Title I of OPA suggests that *Congress intended to preserve state laws of a scope similar to the matters contained in Title I* of OPA, not all state laws similar to the matters covered by the whole of OPA or to the whole subject of maritime oil transport.

Locke, 529 U.S. at 105 (emphasis added). Respondent's contention that Congressional preemptive intent under RESPA is necessarily limited to "the Act" rather than "laws of a scope similar to the matters contained" therein conflicts with this

analysis, and relegates the determination of preemptive intent to a purely rote rule application.[3]

Respondent's other principal argument is that Congress did not save state escrow interest laws because Congress declined in RESPA to empower the Secretary to federally regulate escrow interest (*e.g.*, Resp. Br. 14). This argument necessarily depends on a conclusion that only the *identical* matters affirmatively regulated by RESPA were intended to be saved by 12 U.S.C. § 2616. But the RESPA legislative history, quoted *supra*, supports a broader reading of how to define the "preserve[d] state laws of a scope similar" here, and establishes that Congress intended to "permit States to enforce consumer protection requirements in connection with residential real estate transactions in addition to [*not* "identical to"] requirements of this Act." 1974 U.S.C.C.A.N. at 6572. Consistent with this expressed intent, the Secretary has interpreted § 2616 to apply to "laws relating to escrow accounts," and has specifically identified state escrow interest laws as among them.[4]

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3. "There is not - and from the very nature of the problem there cannot be - any rigid formula or rule which can be used. . . ." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

4. The payment of escrow interest was specifically considered by Congress when RESPA was passed. *See* Pet. 8-9. And both parties cite to the Federal Register passage by the Secretary regarding "state laws regarding escrow interest," which notes the belief of commenters "that a required interest payment on escrow account balances would create a disincentive to servicers to over-escrow." *See* Pet. 7, Resp. Br. 17. One of the express purposes of RESPA is to "result . . . in a reduction in the amounts home buyers are required to place in escrow accounts." 12 U.S.C. § 2601(b)(3). Importantly, escrow interest frequently is credited directly to the escrow account balance, as with Petitioners here. Thus, if not identical to the methods adopted in RESPA, then requiring the payment of escrow interest surely is "of a scope similar to the matters contained" therein, and is entirely consistent with Congress' purpose described in § 2601(b)(3).

The presumption against preemption would have compelled the Second Circuit to interpret these sources and § 2616 more broadly than it did in rejecting Petitioners' contention that §§ 2601(b)(3) and 2609 are of a "scope similar" to state escrow interest laws (Pet. App. A, 9a-11a). Instead, citing *Locke*, the Second Circuit concluded that the longstanding, substantial federal occupation of banking caused the presumption to "disappear" (Pet. App. A, 6a). But banking is substantially different than the international maritime regulation in *Locke*, on which the Second Circuit relied for its "disappearing" conclusion. The constitution of The Bank of New York, one of the oldest banks in the United States, was written by Alexander Hamilton, the individual most actively involved in its organization, in 1784. *See* http://www.bankofny.com/htmlpages/ahi.htm. State savings and loans preceded FS&L's. And RESPA's legislative history (Pet. 8-9) confirms that state escrow account laws, including escrow interest laws, *preceded* the passage of RESPA in 1974.

As opposed to *Locke*, 529 U.S. at 108, or *de la Cuesta*, 458 U.S. at 168, this is not a case where the lack of nationwide uniformity will have a material adverse affect on the Congressionally intended federal scheme. Aside from a passing reference to the potential for "harm [to] the efficient operation of a federal association" (Resp. Br. 9), no adverse material consequence has ever been articulated by Respondent. The Second Circuit credited as reasonable (Pet. App. A, 8a) the OTS' express intention in 12 C.F.R. § 560.2(a) (Pet. App. D, 64a): "OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation." But "flexibility" is the antithesis of "uniformity," and at best a weak justification for the questionable preemption here. *See* Pet. 24 n.6.

This case presents another complication *not* present in *Locke*, because it involves not only overlapping statutes but the overlapping exercise of federal administrative authority.

As this Court has frequently observed, including in *Locke*, 529 U.S. at 110 ((quoting *City of New York v. FCC*, 486 U.S. 57, 63-64 (1988)), a "'federal agency *acting within the scope of its congressionally delegated authority* may pre-empt state regulation'" (emphasis added). Here, it clear that the Secretary is acting within the scope of expressly delegated authority under RESPA, but nothing expressly delegates comparable authority regarding escrow accounts to the OTS. *See* Pet. 21-22. Rather, the OTS *concedes* that FS&L's are bound by RESPA (*see* Pet. 11) – a concession that is *inconsistent* with the OTS' purported "exclusive" authority described in 12 C.F.R. § 545.2 (*see* Pet. App. D, 63a). And the importance of the delegation issue has increased substantially in light of the OCC's recent escrow account preemption regulations modeled after the OTS regulations, as reflected in the Federal Register and of which this Court may properly take judicial notice. *See* Pet. 29-30.

A "saving clause" necessarily defines the "outer limits" of the power of a Congressionally delegated federal administrator to regulate, and more particularly in this case, to pre-empt. Contrary to the OTS regulations purporting to "occupy the field," and the Second Circuit conclusion that "Federal Law Preempts the Field" (Pet. App. A, 3a), "the saving clause [in this case] *negates* the inference that Congress 'left no room' for state [law]." *Int'l Paper Co. v. Ouellette*, 479 U.S. 481, 492 (1987) (emphasis added). Congressional intent, as determined from all appropriate sources, must control the propriety of the OTS preemption of state escrow interest laws in this case.

II. Review Is Warranted Because The Second Circuit Opinion Ignores And Misapplies This Court's State Action And Taking Decisions

In *de la Cuesta*, this Court observed that Respondent and other FS&L's were "'establish[ed] with the force of the government behind them, with a national charter.'" 458 U.S. at 166 (quoted Resp. Br. 7) (citation omitted). As Respondent

further admits, and as the OTS itself has stated, "federal associations . . . are uniquely federalized institutions" *See* Resp. Br. 20-21; *see also* Pet. 27. FS&L's are federal instrumentalities (*see* Pet. 26-27). Thus, at the outset, this case is *not* one that involves purely "private parties, and 'turns on . . . judgments made by private parties' without 'standards . . . established by the State'"). *Am. Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40, 52 (1999) (quoting *Blum v. Yaretsky*, 457 U.S. 991, 1008 (1982)).

Respondent's contention that the outcome of *Am. Mfrs.* controls here (Resp. Br. 23, 24-5) is mistaken. Here, "'the specific conduct of which the plaintiff complains,'" *Am. Mfrs.*, 526 U.S. at 51 (quoting *Blum*, 457 U.S. at 1004), is Respondent's failure to pay the escrow interest *required under New York law*. What previously may have been a private choice is now a "public" obligation. Unlike *Am. Mfrs.*, *id.* at 52, the OTS was "directly involved" in Respondent's failure to pay the required interest; Respondent affirmatively relies on the OTS preemption regulations and opinion letters going back to 1984 (Resp. Br. 12 n.8) - and Respondent even requested the OTS to issue an opinion letter *in this case* (*see* Pet. 25). Unlike the limited Bureau participation in *Am. Mfrs.*, *id.* at 54-55, the OTS involvement is "pervasive and substantial," and coercively eliminates Petitioners' property right in the escrow interest otherwise guaranteed under state law. *See Edmonson v. Leesville Concrete Co.*, 500 U.S. 614, 635-36 (1991) (Connor, J. dissenting).

According to the other principal "state action" authority cited by Respondent (Resp. Br. 23-24), *Andrews v. Fed. Home Loan Bank of Atlanta*, 998 F.2d 214, 217 (4th Cir. 1993), "conduct is fairly attributable to the state" "when the state has committed an unconstitutional act in the course of enforcing a right of a private citizen." Assuming *arguendo* Respondent could be considered a "private citizen," then the test is satisfied by the taking of Petitioners' property and giving Petitioners' interest to Respondent in order to enforce the "right" of Respondent not to pay what is otherwise mandated by the State. The direct transfer of private property to another private party without just compensation is presumptively

unconstitutional. *See Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 241 (1984).

This case presents a Fifth Amendment taking and "state action" issue worthy of review.

III. Review Is Warranted Because Of The Importance Of This Case

The Court should reject Respondent's attempt to minimize the importance of this case (Resp. Br. 25-26). Disregard by the Executive Branch for the intent of the Framers and Congress, and for fundamental principles of federalism, is a violation of the democratic compact between the government of this Nation and its people. Whether the specific number of potentially affected mortgage borrowers is in the hundreds of thousands or millions, and whether the specific amount of escrow interest at stake totals in the hundreds of millions or billions of dollars *each year*, the importance of this case to mortgage borrowers in the United States and its territories is vast.

CONCLUSION

For all of the reasons herein and in the Petition, Petitioners respectfully request that the Supreme Court grant review of this matter.

Respectfully submitted,

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